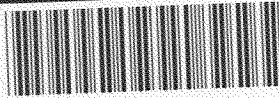


ESCO TECHNOLOGIES INC.



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Washington, DC 20549

INNOVATION-INSPIRED

TECHNOLOGY-DRIVEN

RESULTS-ORIENTED

ANNUAL  
REPORT

2012

At ESCO Technologies, there is a common thread that runs through our corporate culture and each of our divisions. We are proud that the products and services we offer our customers are consistently **INNOVATION-INSPIRED**, from Aclara's award-winning STAR® ZoneScan® Leak Detection System for water utilities to the image clarity and patient comfort achieved with ETS-Lindgren's unsurpassed RF-shielded MRI enclosures for health care facilities.

While innovation is key to creating highly valued products and services, our vast experience as a **TECHNOLOGY-DRIVEN** enterprise is also a crucial component of our success. Whether it is PTI's and Crissair's precision-engineered filtration and fluid control products for Boeing & Airbus, VACCO's latch valves for the Mars Science Laboratory, or Doble's rugged diagnostic test instruments for electric utilities, there are thousands of reasons why the word "Technologies" is part of our name!

And while our top priority is to stay pinpoint focused on robust customer solutions, we keep an equally sharp eye on the bottom line. It is with our long-term, three-segment business strategy and **RESULTS-ORIENTED** management approach that we are able to continue to build shareholder value during these challenging times for the U.S. and global economies.



*Victor L. Richey, Chairman,  
Chief Executive Officer,  
and President;  
Gary E. Muenster, Executive  
Vice President and Chief  
Financial Officer; and  
Alyson S. Barclay, Senior  
Vice President, Secretary,  
and General Counsel*

## TO OUR SHAREHOLDERS

**W**e often comment on the diversity of our products and end-markets as being one of our most recognizable strengths — we believe this year was no exception. While there is a lot of uncertainty in the global economy, fortunately for ESCO, our multi-segment platform continues to provide us with the resilience to withstand these challenges. The fundamental drivers of our business have not changed over the past few years as a result.

We supply fluid control products for nearly every commercial aircraft flying today, as well as providing highly-engineered, mission critical products that allow our Space Program to flourish in its exploration endeavors. VACCO provided several critical components to the highly successful Mars Rover Program, as well as numerous sole-source products on the launch and delivery vehicles that got it there.

We are partnered with SoCalGas on the largest domestic AMI deployment in history, and when completed, the utility's six million customers will have their gas meters read remotely and accurately, while having nearly real-time access to usage patterns and conservation alternatives.

We also serve a critical role in enhancing the reliability of the electric grid worldwide as we provide test,

diagnostic, asset quality, and risk mitigation solutions that allow utilities to proactively address grid management and power delivery issues. Doble currently provides hardware, software, services and solutions to nearly 95 percent of all domestic electric utilities.

Our Test and its related Systems business supports the development of new products in dozens of industries worldwide. Our products assist in the advancement of new technologies in the areas of wireless communications, secure communications, medical imaging, and asset protection.

We could talk tirelessly about the breadth and reach of our products, services, and solutions, but to put it simply: We are a Company with the management talent, engineering expertise, marketing creativity, and

manufacturing capability necessary to innovate, adapt, and change—promoting success today, and enhancing it over the long term. We recognize the changing landscape and trends in our served markets, work closely with our customers, and adapt quickly to develop the innovative solutions our customers require.

2012 was a challenging year as we transitioned from the completion of two large AMI projects with PG&E and New York City, into the initial launch of the SoCalGas project. While we missed our original earnings expectations in 2012, we maintained solid profitability with strong operational performance and solid cash flow across the business.

We recognized several significant accomplishments during the year, led by the largest amount of orders recorded in our history. We added \$752 million in new

business, led by USG with \$380 million in orders and \$62 million in backlog growth. The strength of our overall orders and the resulting backlog growth certainly bode well for the future.

Regarding our outlook for 2013 and beyond, we remain extremely positive about our future. The largest portion of our 2013 growth will come from SoCalGas, which will also provide a solid revenue base through 2016. Our sales and earnings visibility over the next few years has become more clearly defined, and as a result, we remain confident that we have meaningful growth opportunities across all three segments.

With regard to non-organic growth, we continue to explore and evaluate acquisitions across all three platforms, with our primary focus on USG. We will remain prudent and disciplined in our approach, and will main-

## GLOBAL REACH

With operations in 27 locations around the world, the businesses of ESCO Technologies serve markets in more than 80 countries on six continents.

### ■ Markets Served

#### ● ESCO Operations

##### North America

Cedar Park, TX  
Durant, OK  
Glendale Heights, IL  
Greenwood Village, CO  
Huntley, IL  
Minocqua, WI  
Oxnard, CA  
Palmdale, CA  
Raleigh, NC  
Solon, OH  
South El Monte, CA  
St. Louis, MO  
Watertown, MA  
Wellesley, MA

##### South America

São Paulo, Brazil

##### Europe

Dresden, Germany  
Eura, Finland  
Guildford, England  
Luxembourg, Luxembourg  
Stevenage, England  
Taufkirchen, Germany  
Trondheim, Norway

##### Africa

Pietermaritzburg,  
South Africa

##### Asia

Bangalore, India  
Beijing, China  
Tokyo, Japan

##### Australia

New South Wales,  
Australia



tain a strong and healthy balance sheet that gives us the flexibility to invest in growth, regardless of economic cycles.

We will continue our focus on costs and competitive positioning to ensure we effectively execute our business plans. The Test business restructuring was undertaken to enhance our overall efficiency and to improve our operating margins. We continue to examine several other opportunities across the Company to scale our cost structure to further leverage our growth, thereby increasing shareholder returns.

Our employees remain key contributors to our success, as our team is talented, passionate, and innovative. This letter would not be complete without expressing a sincere thank you to all of the employees of ESCO for their exceptional commitment. We also extend our

appreciation to our Board of Directors for its strategic guidance and effective corporate governance, and we also want to thank our shareholders for their support.

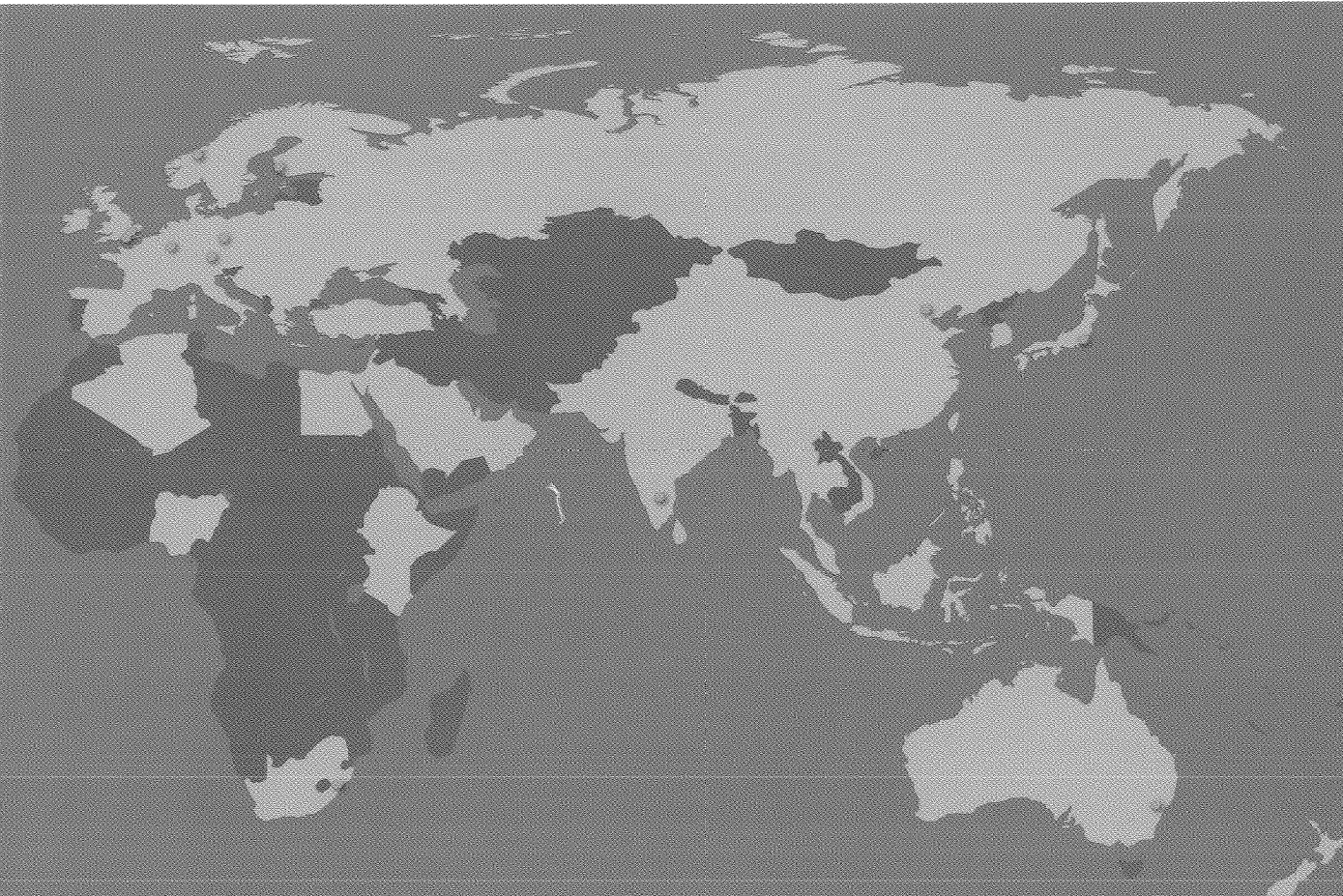
As we look to the future, we are confident we have the right strategies in place, coupled with multiple opportunities for growth across our operating platforms. We look forward to executing our growth strategies and continuing to create shareholder value for years to come.



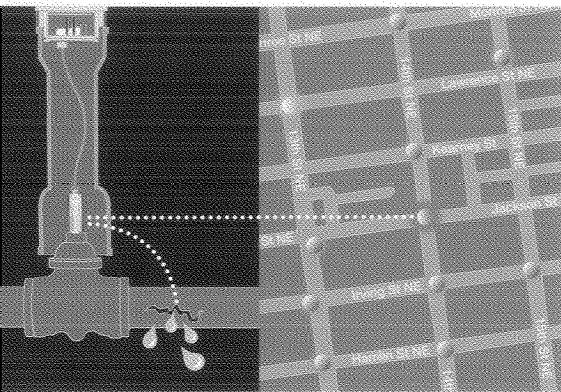
Vic Richey  
Chairman, Chief Executive  
Officer, & President  
November 29, 2012



Gary Muenster  
Executive Vice President  
& Chief Financial Officer



IN THE UTILITY SOLUTIONS GROUP, ACLARA IS THE INDUSTRY LEADER IN ADVANCED METERING INFRASTRUCTURE SOLUTIONS AND ANALYTICS FOR GAS, WATER AND ELECTRIC UTILITIES. USING OUR PRODUCTS, UTILITIES COLLECT, STORE, AND ANALYZE SMART-METER DATA AND USE IT TO INFORM AND ENGAGE THEIR CONSUMERS. DOBLE IS A UNIQUE PARTNER TO ELECTRIC UTILITIES EVERYWHERE, PROVIDING MORE THAN 5,500 COMPANIES WITH DIAGNOSTIC TEST INSTRUMENTS, CONSULTING AND TESTING SERVICES, AND THE WORLD'S LARGEST DATABASE OF INFRASTRUCTURE ASSET TEST RESULTS.

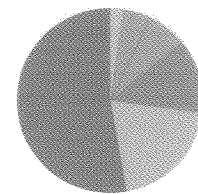


*In conjunction with Gutermann's leak-detection technology, Aclara's award-winning STAR® ZoneScan® system automates the collection and analysis of acoustic signatures to identify the presence and location of water main leaks, saving substantial time and money for water utilities everywhere.*

**ACLARA** Faced with limited resources, utilities continually seek to do more with less. Aclara delivers targeted and innovative solutions to help utilities and their customers be better stewards of our natural resources and the environment.

**LEADING THE WAY:** STAR® ZoneScan® is an award-winning correlated, acoustic fixed-network leak detection product that enables utilities to find hidden water leaks in underground infrastructure without disruptive digging or antiquated manual logging. Similarly, Aclara leads the charge to bring advanced analytics to all utilities for data-rich applications such as demand response, distribution automation and asset analysis. Our approach provides cost-effective, high-value solutions that satisfy the varied demands of utilities ranging in size from a few thousand customers to several million.

**ENABLING TECHNOLOGIES:** The TWACS® and STAR® networks are industry-leading, fixed-network AMI systems that collect, store and analyze meter data

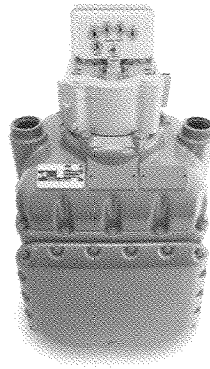


**International Utility Market**

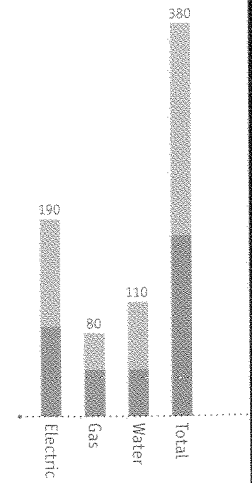
- 53% Asia
- 20% Europe
- 13% N. America
- 7% S. America
- 5% Africa/Middle East
- 2% Other

that electric, gas and water utilities use to make better operational and planning decisions. Aclara's technologies have solved some of the most daunting problems in the industry, including demonstrated 20-year battery life and the ability to reach the "last mile" customer—without costly infrastructure changes. Our consumer engagement products use all communications channels, from paper reports to the very latest in mobile and web technology. They enable utilities to target their consumers with tremendous precision, exchange information with them and amplify the value of engaged consumers.

**PROVEN LEGACY:** Our fixed-network AMI communications technologies form the back-bone of utility meter data infrastructure by providing accurate bill-



*The STAR Network Series 3000 Meter Transmission Units for gas utilities provide accurate and timely meter data to virtually eliminate estimated revenue management and reduce customer service calls.*



**North American Market Opportunity By Utility Type**

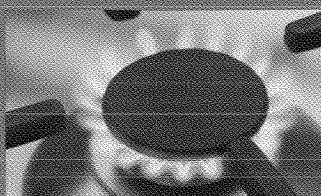
Millions of Meters

■ Available  
■ Automated (AMR/AMI)

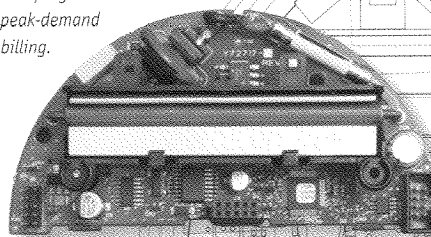
ing information. Utilities depend on these communication networks to collect critical performance metrics, monitor the health of installed assets and optimize the performance of their entire system. Because of Aclara's proven legacy of reliability, scalability, and dependable performance, we continue to win significant projects with leading gas, water and electric utilities.

## SOLUTIONS

*Aclara's integrated AMI solutions provide the hardware, software, advanced networks and services to support electric, water and gas utilities of **any** size, in **any** combination with **any** service territory.*



*Aclara's Universal Metering Transponder for residential meters sends highly reliable interval meter readings to electric utilities, enabling advanced rate programs such as peak-demand billing.*

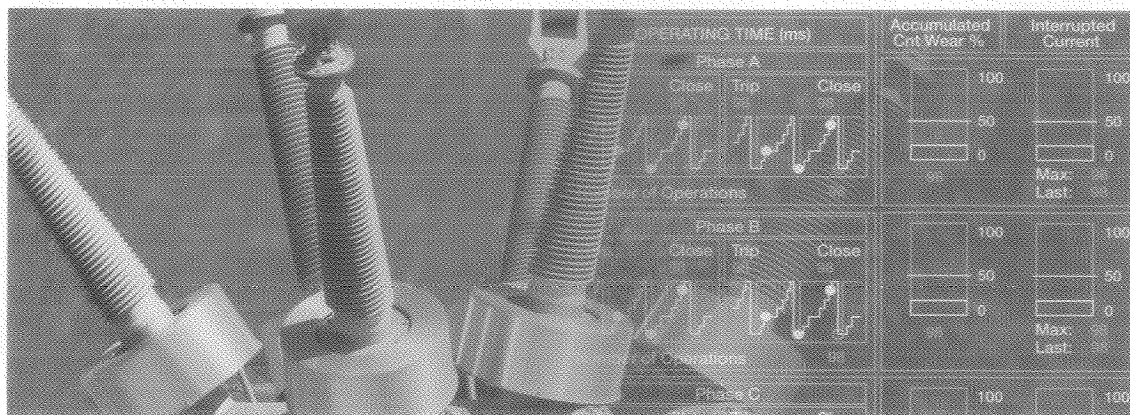


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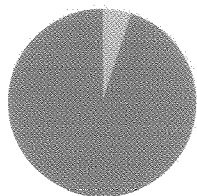
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KWH/KW

2012 ANNUAL REPORT 5



*Doble's Asset Risk Management System (doleARMS™) brings decades of knowledge and experience with diagnostics and data analysis to the areas of online monitoring, condition assessment and the strategic management of assets.*



#### Doble Clients

■ 95% Doble

■ 5% Other

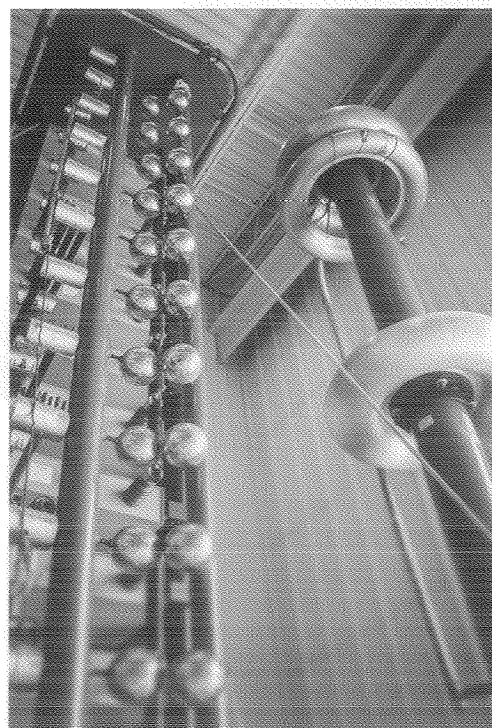
*95% of all U.S. investor-owned electric utilities are Doble clients.*

**DOBLE** For nearly a century, Doble Engineering Company has partnered with electric power industry clients to minimize risk, improve operations and optimize system performance. Doble provides enterprise level solutions, engineering expertise, on-line and off-line diagnostic instruments, consulting and testing services, educational seminars and the world's premier library of electrical apparatus test data for the benefit of the global power industry. Doble has a reputation for excellence, earned through the experience of our engineers and the quality of our products and services.

**SOLUTIONS FOR A NEW ERA:** Today's power industry faces a series of complex changes—an aging workforce, new compliance and security concerns, as well as a shift towards on-line monitoring. Doble is evolving with the industry, and has developed doleARMS™, an enterprise asset

management system, along with a comprehensive suite of on-line monitoring solutions. In addition, Doble continues to enhance the advanced off-line testing tools that are trusted around the globe for reliability and ruggedness.

**ENGINEERING EXPERTISE:** Customers continually rely on Doble because of the strength and expertise of the Doble team. Doble's engineers are an invaluable resource for technical support, training and consultation. Members of the Doble team

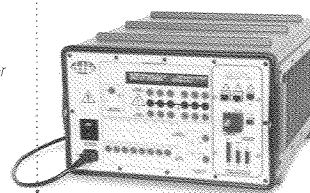


*Advanced testing is performed inside Doble's High Voltage Laboratory including endurance testing, research on dielectric behavior, failure analysis and partial discharge detection.*



*Doble engineers perform advanced and routine testing, and also support clients with analysis of test results, training, consultation and technical support.*

*This year Doble introduced the F6150sv, an advanced protection test set with enhanced features for wireless communication and IEC61850 compliance for smart grid applications.*



serve on international standards committees such as the Institute of Electrical and Electronics Engineers (IEEE), the International Electrotechnical Commission (IEC) and the International Council on Large Electric Systems (CIGRE) to ensure the voices of clients are being represented. Doble's engineers and chemists are industry leaders, honored for their dedication and service, and respected for their knowledge and unbiased opinions.

**KNOWLEDGE IS POWER:** Doble is the custodian of the industry's largest database of test results, service advisories, technical papers and presentations. Doble's First Response Analytics Knowledgebase™ or FRANK™ is an artificial intelligence engine that leverages the data to provide clients

*Chemists in Doble's Materials Laboratories develop cost-effective testing programs for condition assessment and perform a variety of tests to help identify and solve apparatus problems.*

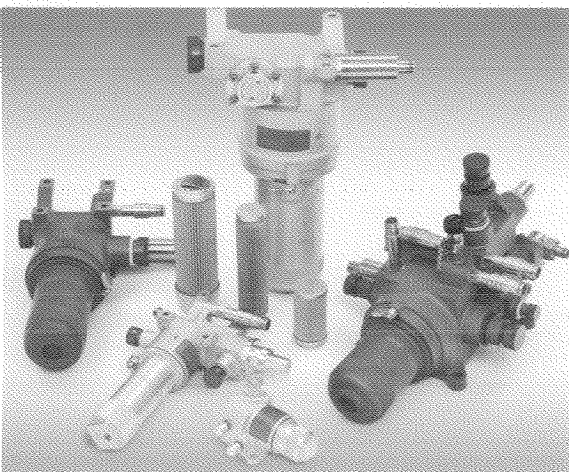


*A Doble engineer performs on-site testing using Electromagnetic Interference Diagnostics™, an on-line survey that detects both electrical and mechanical defects in generators, motors, isolated phase bus ducts and transformers.*

with analysis and recommendations enabling companies to make informed financial decisions about the health of their electrical assets.

**THE FUTURE OF DOBLE:** Evolution is key. Doble continues to invest in new technology and grow internationally, while staying true to our core foundation of providing quality products, services and knowledge to the electric power industry.

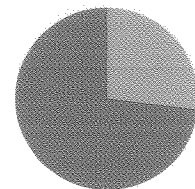
BUILDING ON A HERITAGE OF INNOVATION-INSPIRED FLUID CONTROL SOLUTIONS, THE COMPANIES IN OUR FILTRATION/FLUID FLOW SEGMENT—CRISSAIR INC. (CRISSAIR), PTI TECHNOLOGIES INC. (PTI) AND VACCO INDUSTRIES (VACCO)—CONTINUE TO DELIVER HIGHLY ENGINEERED FLUID CONTROL SOLUTIONS FOR MISSION CRITICAL SYSTEMS. AS TECHNOLOGY-DRIVEN LEADERS, THE COMPANIES ARE COMMITTED TO SATISFYING CUSTOMERS IN A DIVERSE GROUP OF END MARKETS, INCLUDING COMMERCIAL AEROSPACE, SPACE AND DEFENSE, SATELLITE COMMUNICATIONS, MEDICAL, INDUSTRIAL AND AUTOMOTIVE.



*PTI provides the complete set of hydraulic filter manifolds for the Airbus A350 XWB program, ensuring cleaner operation, optimum efficiency and better economy.*

**HERITAGE:** The Company's Filtration/Fluid Flow business is built upon successful integration of technology, application knowledge and engineering capability while embracing mutual commitment and collaboration with our customers. This tradition has positioned the company to address complex fluid control challenges and opportunities by providing highly engineered products directly to Original Equipment Manufacturers and line replaceable units and spares to the after-market. A deep understanding of the aerospace, defense and industrial markets has resulted in proprietary products that comprehensively address the needs of the manufacturer and operator.

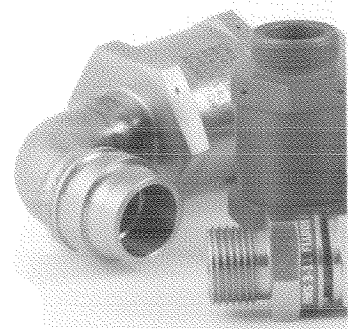
**INNOVATION:** Our core competence in the area of fluid flow control equipment design has produced hundreds of products with a broad range of complexity. The companies are technology-centered and committed to satisfying customer needs through innovative research and development programs. VACCO's advanced propulsion products helped the



#### Proprietary Products

- 73% Proprietary
- 27% Competitive

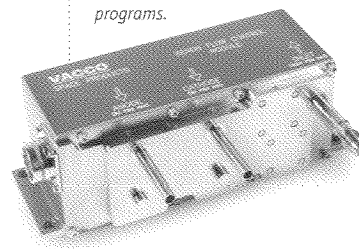
*Seventy-three percent of our Filtration segment contracts are for products for which ESCO has been selected as the sole provider.*





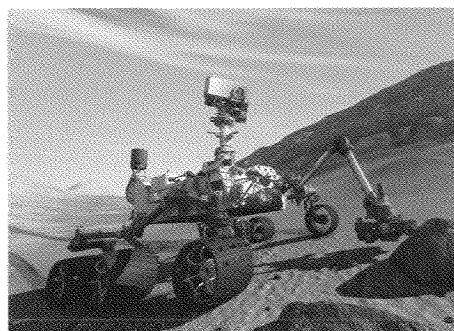
*Our comprehensive filtration and fluid control solutions enhance our customers' equipment performance, improve reliability, keep people safe and protect the environment.*

*In advancing industry standards, VACCO has designed new technologies that provide entire subsystem critical components in micro-manifolds, reducing size, weight and risk to space programs.*



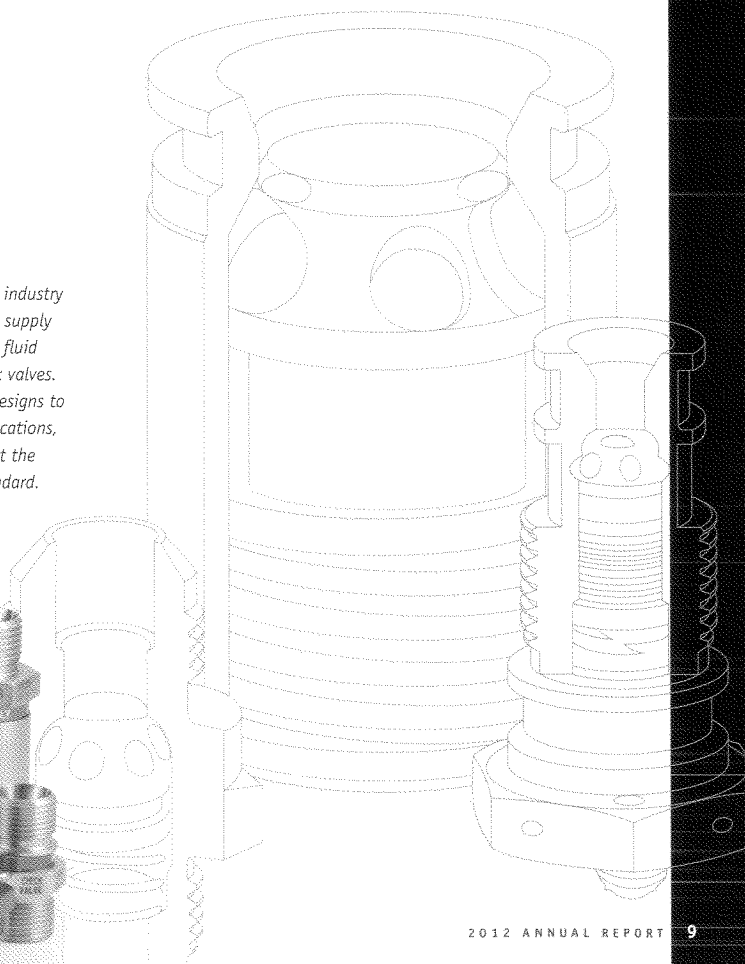
Mars Science Laboratory Mission, one of NASA's most difficult, high-risk missions ever, successfully land the Curiosity rover on Mars. PTI and Crissair continue development of advanced flow control products that improve performance, lengthen operational life and maintain optimal fluid quality on today's most advanced aircraft systems, including the Airbus A350 XWB, the Boeing 787 and the Lockheed Martin Joint Strike Fighter.

**SUCCESS:** Crissair, PTI and VACCO are recognized as well established leaders at providing solution-oriented excellence. Whether maintaining an existing product position or strategically pursuing new markets, technical superiority and next generation innovations are key to continued growth and profitability. Today, our products are essential components of the filtration and fluid flow control process in nearly every major industry.

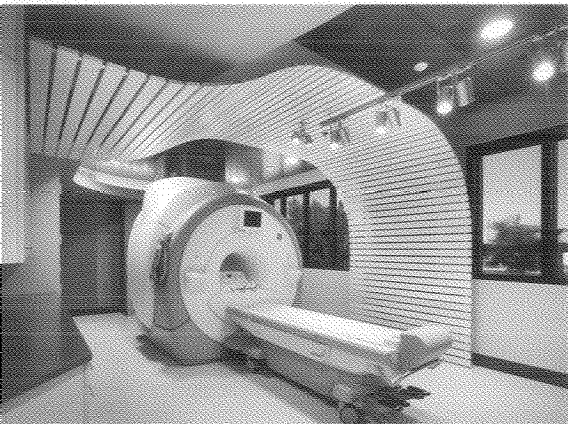
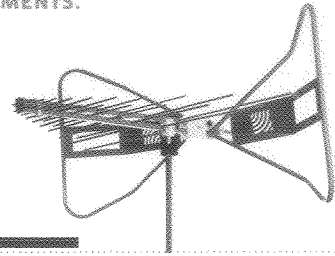


*VACCO provides critical components to the Mars Science Laboratory program, including Latch Valves, Pressure Regulators, Etched Disc & Metal Mesh Filters, and Fill & Drain Valves.*

*Crissair is an industry leader in the supply of aerospace fluid control check valves. From basic designs to custom applications, our valves set the industry standard.*



ESCO'S ETS-LINDGREN SUBSIDIARY IS THE WORLD'S LEADING SUPPLIER OF ELECTROMAGNETIC COMPATIBILITY (EMC) AND RADIO FREQUENCY (RF) TEST FACILITIES, AS WELL AS SHIELDED ENCLOSURES FOR MEDICAL AND SECURITY APPLICATIONS. OUR WORLDWIDE PRESENCE ENABLES US TO SERVE A GLOBAL CUSTOMER BASE AND TAKE ADVANTAGE OF GROWTH IN DEVELOPING MARKETS. WITH AN EMPHASIS ON UNIQUELY ENGINEERED SOLUTIONS, WE ARE ABLE TO QUICKLY ADDRESS NEW AND DEVELOPING TECHNOLOGIES AS WELL AS CONTINUALLY CHANGING CUSTOMER REQUIREMENTS.



*State-of-the-art MRI facilities require both high-quality shielding as well as first-class workmanship to meet the requirements of a demanding customer base.*

ETS-Lindgren supplies fully integrated solutions that allow customers to identify, measure and contain radiated energy. The company's products are used in a variety of applications, including the testing of electronics to meet regulatory standards, the testing of wireless devices to improve product performance and the protection of sensitive equipment and data. With offices throughout the world, we can service our global customer base with localized support.

**TEST SOLUTIONS:** ETS-Lindgren is the worldwide leading supplier of EMC and wireless test systems.

*Product innovation is critical to ETS-Lindgren's success and its ability to help its customers address the unique testing challenges associated with their products.*



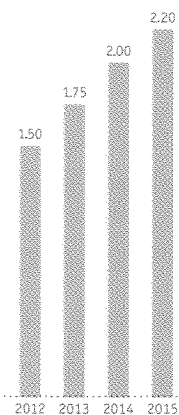
*Test system ease of use and overall test time are critical to anyone designing wireless communication devices. Users also appreciate our aesthetically pleasing work environments.*

With the rapid development of new wireless technologies, such as LTE, ETS-Lindgren's engineering expertise allows customers to test devices accurately and get products to market quickly. Our fully integrated EMC test solutions offer customers the greatest flexibility of any solution on the market and allows them to test products ranging from PC boards to airplanes.

**MEDICAL MARKET:** The shielding of Magnetic Resonance Imaging (MRI) suites is becoming increasingly important as the demand for better image quality and faster patient throughput increases. As new technologies emerge, and the performance of

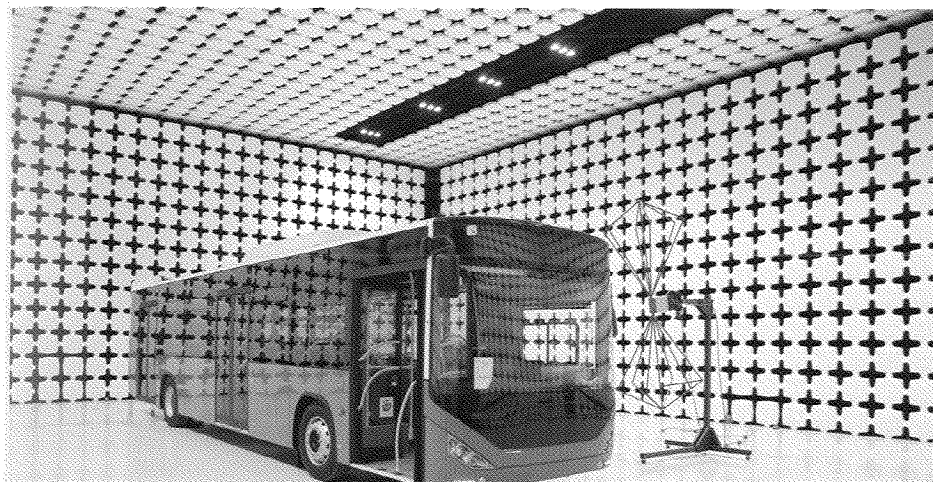
magnetics improves, ETS-Lindgren engineers work with leading suppliers in the industry to develop the next generation of products.

**SECURITY APPLICATIONS:** ETS-Lindgren has long been a leading supplier in the field of secure communication. With the development of new electromagnetic weapons, a new threat has emerged. We are applying our 70 years of experience in designing and installing shielding systems to protect critical equipment and command/control centers from Electromagnetic Pulse (EMP), High Altitude Electromagnetic Pulse (HEMP) and Intentional Electromagnetic Interference (IEMI).

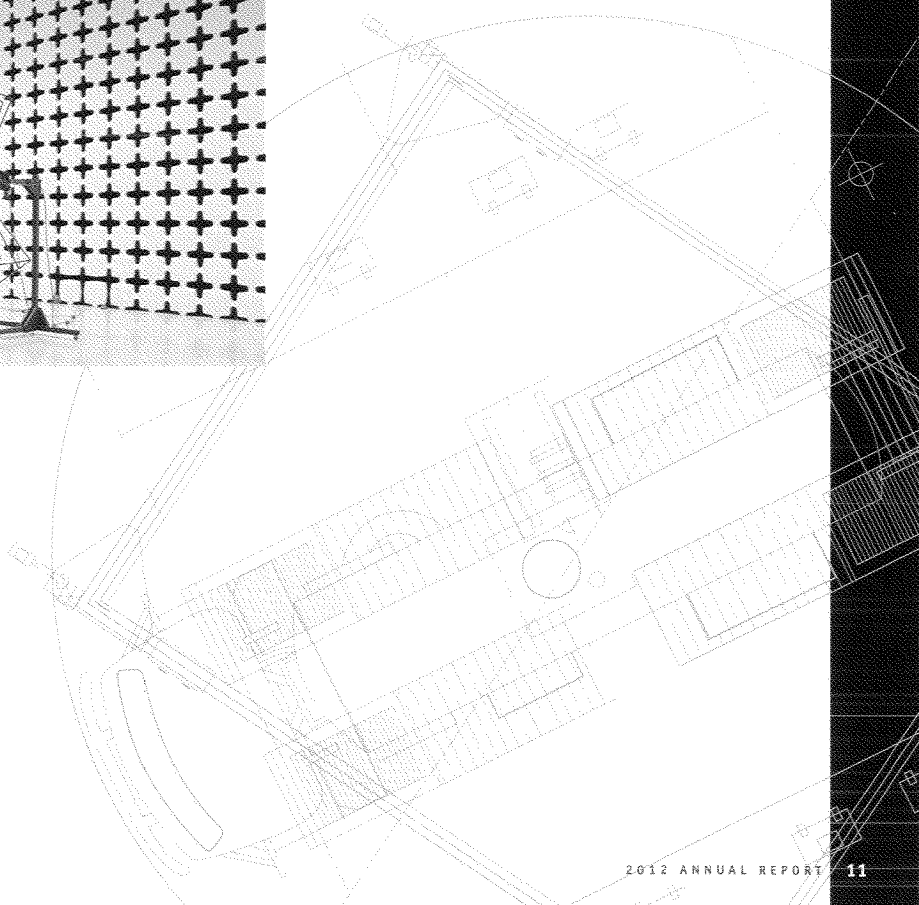


**Projected Global Wireless LAN Product Shipments**  
In Billions

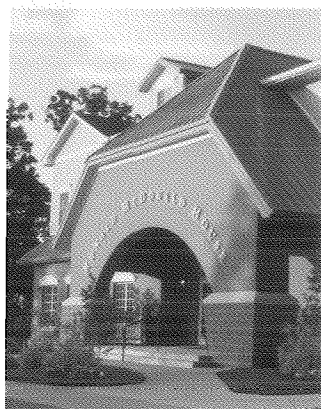
*Global shipments of electronic products with wireless capability are expected to grow dramatically over the next few years.*



*Large vehicles offer unique challenges when it comes to testing. ETS-Lindgren is able to use its expertise to help customers successfully meet all their testing requirements.*

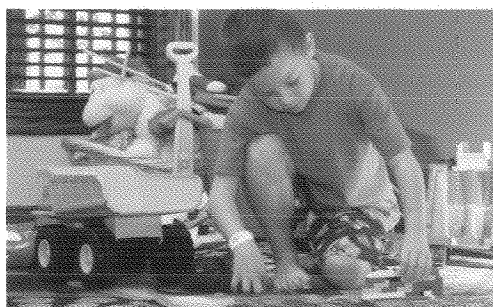


THE ESCO TECHNOLOGIES FOUNDATION IS A PUBLIC CHARITY FUNDED BY DONATIONS FROM ESCO, ESCO EMPLOYEES AND OUTSIDE DONORS. THE FOUNDATION'S MISSION IS TO SUPPORT CHARITABLE ORGANIZATIONS FOCUSING ON CHILDREN AND FAMILIES IN COMMUNITIES WHERE ESCO TECHNOLOGIES HAS OPERATIONS. THE ORGANIZATIONS HIGHLIGHTED BELOW ARE A FEW OF MORE THAN 25 CORE CHARITIES THE FOUNDATION SUPPORTS ANNUALLY.



*The third St. Louis Ronald McDonald House and the 300th in the world was officially opened in 2010. The newest Ronald McDonald House is located on the campus of Mercy Children's Hospital and is a 20-bedroom, three-story house encompassing 18,188 square feet.*

**RONALD MCDONALD HOUSE CHARITIES (RMHC)** (St. Louis, MO) RMHC of Metro St. Louis was established in 1981 and has grown from an eight-bedroom facility to now include three houses and eight extended-stay apartments. With the addition of their newest house (pictured here), they are now able to serve up to 59 families at a time. RMHC provides a warm, home-like atmosphere that allows families to stay close to their hospitalized child and gives them a



place to eat, sleep, relax and spend time with other families facing similar situations. In recent years the Foundation's grants have gone to support the cost to provide lodging to families as well as to refresh and update one of the local RMHC homes.

**FOOTHILL FAMILY SERVICE** (San Gabriel Valley, CA) is a mental health and social service agency committed to building brighter futures by encouraging children and families to overcome challenges and achieve success in relationships, school and work. Our Foundation grant helps support their programs focusing on domestic violence and child abuse pre-

vention and treatment, mental health therapy and counseling, parent education and support, school readiness, and other vital initiatives.

**PEOPLE'S RESOURCE CENTER** (DuPage County, IL) is a multi-faceted social services organization committed to helping the community through its food pantry, distribution of gently used clothing, job search mentoring, emergency rent and mortgage assistance, computer skills training, and literacy programs. Our Foundation grant helps support their English as a Second Language literacy program for parents of Head Start students.

**FIELDSTONE FARM THERAPEUTIC RIDING CENTER** (Cleveland, OH) provides equestrian programs to people with disabilities. Fieldstone Farm serves more than 800 students annually from all over Northeast Ohio. Riders with cognitive impairments, physical disabilities, psychosocial disorders including behavioral issues and sensory impairments, learn riding skills while they improve their balance, strengthen muscles, work on educational goals, learn communication skills, increase their self-esteem and gain confidence. The Foundation provides support to its Academic Enrichment Program that provides "rider-ships" for children with disabilities.

To make a tax-deductible contribution or to learn more about the Foundation, please call 314-213-7277 or visit our website at [www.escotechnologiesfoundation.org](http://www.escotechnologiesfoundation.org).

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The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes thereto. The years 2012, 2011 and 2010 refer to the fiscal years ended September 30, 2012, 2011 and 2010, respectively, and are used throughout the document.

## Introduction

ESCO Technologies Inc. and its wholly owned subsidiaries (ESCO, the Company) are organized into three reportable operating segments: Utility Solutions Group (USG), RF Shielding and Test (Test), and Filtration/Fluid Flow (Filtration). The Company's business segments are comprised of the following primary operating entities:

- **USG:** Aclara Technologies LLC (Aclara), and Doble Engineering Company (Doble),
- **Test:** EMC Group companies consisting primarily of ETS-Lindgren L.P. and Lindgren R.F. Enclosures, Inc., (On October 1, 2012, these entities were merged together and renamed ETS-Lindgren Inc.) and,
- **Filtration:** PTI Technologies Inc. (PTI), VACCO Industries (VACCO), Crissair, Inc. (Crissair) and Thermoform Engineered Quality LLC (TEQ).

**USG:** Aclara is a proven supplier of special purpose fixed-network communications systems for electric, gas and water utilities, including hardware and software to support advanced metering applications. Aclara's STAR® Network system and TWACS® technology provide advanced radio-frequency and power-line based fixed-network technologies proven to meet the wide-ranging data communications requirements of utilities worldwide. Aclara Software applications add value across the utility enterprise, addressing meter and energy data management, distribution planning and operations, customer service, revenue management and integration solutions. Doble provides high-end, intelligent diagnostic test solutions for the electric power delivery industry and is a leading supplier of power factor and partial discharge testing instruments used to assess the integrity of high-voltage power delivery equipment.

**Test:** The EMC Group is an industry leader in providing its customers with the ability to identify, measure and contain magnetic, electromagnetic and acoustic energy.

**Filtration:** The companies within this segment primarily design and manufacture specialty filtration products including hydraulic filter elements used in commercial aerospace applications, unique filter mechanisms used in micro-propulsion devices for satellites and custom designed filters for manned aircraft and submarines.

ESCO continues to operate with meaningful growth prospects in its primary served markets and with considerable financial flexibility. The Company continues to focus on new products that incorporate proprietary design and process technologies. Management is committed to delivering shareholder value through internal growth, ongoing performance improvement initiatives, and acquisitions.

## Highlights of 2012 Operations

- Sales, net earnings and diluted earnings per share were \$688.4 million, \$46.9 million and \$1.73 per share, respectively, compared to sales, net earnings and diluted earnings per share of \$693.7 million, \$52.5 million and \$1.95 per share in 2011.
- Net cash provided by operating activities was approximately \$53 million in 2012.
- At September 30, 2012, cash on hand was \$30.2 million and outstanding debt was \$115 million, for a net debt position of approximately \$85 million. (Net debt position is defined as total debt less net cash.)
- 2012 entered orders were \$752.2 million resulting in a book-to-bill ratio of approximately 1.1x. Backlog at September 30, 2012, was \$406.9 million compared to \$343.1 million at September 30, 2011.
- The Company received \$74.6 million in orders and recorded \$13 million in sales during 2012 related to the Company's agreement with Southern California Gas Co. (SoCalGas). SoCalGas' project includes deployment of Aclara's integrated hardware, software and network architecture solution to over six million customers throughout its service territory. As of September 30, 2012, total orders received from SoCalGas were \$94.5 million. Subsequent to fiscal year-end, the Company received \$41 million in orders in October 2012 from SoCalGas.
- The Company acquired a minority interest in Calico Energy, Inc. (Calico) for \$3.3 million in 2012. Calico is a provider of demand response software used in smart grid deployments and will be offered in connection with Aclara's Smart Communications Network solution.
- The Company declared dividends of \$0.32 per share, totaling \$8.6 million in payments during 2012.
- During the fourth quarter of 2012, the Company spent \$5.4 million to repurchase approximately 150,000 shares of its common stock. Subsequent to fiscal year-end, the Company spent an additional \$9.7 million to repurchase approximately 270,000 shares.

## Results of Continuing Operations

### NET SALES

(Dollars in millions)	Fiscal year ended			Change 2012 vs. 2011	Change 2011 vs. 2010
	2012	2011	2010		
USG	\$317.7	349.6	348.3	(9.1)%	0.4%
Test	175.9	176.5	138.4	(0.3)%	27.5%
Filtration	194.8	167.6	120.8	16.2 %	38.7%
Total	\$688.4	693.7	607.5	(0.8)%	14.2%

Net sales decreased \$5.3 million, or 0.8%, to \$688.4 million in 2012 from \$693.7 million in 2011. The decrease in net sales in 2012 as compared to the prior year was due to: a \$31.9 million decrease in the USG segment; a \$0.6 million decrease in the Test segment; partially offset by a \$27.2 million increase in the Filtration segment.

#### USG

The net sales decrease of \$31.9 million, or 9.1%, in 2012 as compared to the prior year was primarily due to: a \$34.6 million decrease in net sales from Aclara due to lower deliveries of Advanced Metering Infrastructure (AMI) products for the New York City water project (\$17.4 million), the Pacific Gas & Electric Company (PG&E) gas project (\$18.4 million) and the Federal Commission of Electricity (CFE) electric project in Mexico (\$29.6 million) as these projects near completion. Partially offsetting this sales decrease, sales to electric utility cooperatives increased \$19 million and sales to SoCalGas increased \$11.7 million in 2012 as compared to the prior year. Net sales from Doble increased \$2.7 million in 2012 as compared to the prior year driven by an increase in service revenues.

The net sales increase of \$1.3 million, or 0.4%, in 2011 as compared to 2010 was due to: a \$21.8 million increase in net sales of Aclara's TWACS® products primarily due to higher shipments to CFE; an \$11.7 million increase in net sales from Doble driven by higher product shipments; a \$3.3 million increase in net sales from Aclara's software products mainly due to the Xtensible acquisition (acquired September 3, 2010); partially offset by a \$32 million decrease in net sales from Aclara's STAR® products related to the PG&E gas project and a \$10 million decrease for the New York City water project.

#### Test

The net sales decrease of \$0.6 million, or 0.3%, in 2012 as compared to the prior year was due to: a \$6 million decrease in net sales from the segment's U.S. operations primarily driven by lower shipments of shielding for a NASA project

in Florida as the project nears completion; a \$1.3 million decrease in net sales from the segment's European operations; partially offset by a \$7 million increase in net sales from the segment's Asian operations due to several chamber projects in China.

The net sales increase of \$38.1 million, or 27.5%, in 2011 as compared to 2010 was due to: a \$15.5 million increase in net sales from the segment's U.S. operations mainly driven by a large project for NASA in Florida; a \$17.3 million increase in net sales from the segment's European operations mainly due to the EMV acquisition that contributed \$11 million; and a \$5.4 million increase in net sales from the segment's Asian operations due to several large chamber projects in Japan.

#### Filtration

The 16.2%, or \$27.2 million increase in net sales in 2012 as compared to the prior year was due to: an \$8.6 million increase in net sales from VACCO due to higher shipments of its Space products; a \$6.6 million increase in net sales at TEQ mainly due to higher shipments to commercial customers; a \$6.5 million increase in net sales at PTI driven by higher shipments of aerospace assemblies, elements and couplings; and a \$5.5 million increase at Crissair mainly due to higher product shipments and price increases on its products.

The 38.7%, or \$46.8 million increase in net sales in 2011 as compared to 2010 was due to: a \$22.9 million increase in net sales from Crissair (which was acquired effective July 31, 2010); a \$12.7 million increase at TEQ due to higher shipments of its ear thermometer probe cover product; an \$8.2 million increase in net sales from VACCO due to higher shipments of Virginia Class submarine products and defense spares shipments; and a \$3 million increase at PTI driven by higher shipments of aerospace assemblies and elements.

#### ORDERS AND BACKLOG

New orders received in 2012 were \$752.2 million as compared to \$676.1 million in 2011, resulting in order backlog of \$406.9 million at September 30, 2012, as compared to order backlog of \$343.1 million at September 30, 2011. In 2012, the Company recorded \$380.1 million of orders related to USG products, \$168.5 million related to Test products, and \$203.6 million related to Filtration products. Orders are entered into backlog as firm purchase order commitments are received.

In 2011, the Company recorded \$321.4 million of orders related to USG products, \$189.1 million related to Test products, and \$165.6 million related to Filtration products.

Aclara received \$74.6 million in orders and recorded \$13 million in sales during 2012 related to the Company's agreement with SoCalGas. SoCalGas' project includes deployment of Aclara's integrated hardware, software and network architecture solution to over six million customers throughout its service territory. Most of the equipment will be ordered by placement of formal purchase orders under the agreement. As of September 30, 2012, total orders received from SoCalGas for AMI gas products were \$94.5 million. Subsequent to September 30, 2012, the Company received \$41 million in orders in October 2012 from SoCalGas.

Aclara received orders from PG&E for AMI products of \$11.4 million, \$17 million and \$54 million during 2012, 2011 and 2010, respectively. Cumulative-to-date orders from PG&E for the gas AMI deployment total 4.9 million units and \$280 million through September 30, 2012, as the contract nears completion.

### 2011

Aclara received an additional \$21 million order to supply products to Mexico's electric utility, CFE, related to its electric AMI deployment.

Aclara also received approximately \$20 million of orders in 2011 from SoCalGas related to its gas AMI deployment.

The Test segment received a \$6.5 million order for an anechoic test chamber in South America used to test telecommunications satellites, and a \$5.4 million order in Turkey for a chamber used to identify electromagnetic interference for a variety of large motorized vehicles.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses (SG&A) were \$186.1 million, or 27% of net sales in 2012, \$182.5 million, or 26.3% of net sales in 2011, and \$157.3 million, or 26% of net sales in 2010.

The increase in SG&A expenses in 2012 as compared to the prior year was mainly due to: a \$3.5 million increase within the Filtration segment due to new product development costs for additional Space product applications, additional content on Airbus platforms, and an increase in head count; a \$1.9 million increase within the Test segment due to the EMV acquisition (acquired February 28, 2011); partially offset by a \$1.7 million decrease within the USG segment primarily due to lower new product development costs as projects were completed and the related products were introduced to the market.

The increase in SG&A expenses in 2011 as compared to 2010 was due to: an \$11.4 million increase within the USG segment due to new product development, marketing and engineering expenses; a \$7.7 million increase within the Test segment primarily due to the 2011 acquisition of EMV and SG&A to support the international marketplace expansion; and a \$6.1 million increase within the Filtration segment mainly due to a full year of costs from Crissair (versus two months in 2010).

### AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets was \$13.3 million in 2012, \$12 million in 2011 and \$11.6 million in 2010. The Company recorded \$4.7 million, \$4.7 million and \$4.5 million in 2012, 2011 and 2010, respectively, related to Aclara's TWACS NG capitalized software. Amortization of intangible assets included \$4.5 million, \$4.6 million and \$4.8 million of amortization of acquired intangible assets related to the Company's acquisitions in 2012, 2011 and 2010, respectively. The amortization of acquired intangible assets related to the Company's acquisitions is included in the Corporate operating segment's results. The remaining amortization expenses consist of other identifiable intangible assets (primarily software, patents and licenses) and are included in the respective segment's operating results.

### OTHER (INCOME) EXPENSES, NET

Other (income), net, was (\$3.9) million in 2012 and (\$5.1) million in 2011 compared to other expenses, net, of \$2.9 million in 2010, respectively. The principal component in other (income) expenses, net, in 2012 and 2011 was (\$4.5) million and (\$7.6) million, respectively, of income representing a revaluation of the earnout liability related to the Xtensible acquisition. The principal item included in other expenses, net, in 2010 was \$1.5 million of severance expenses. There were no other individually significant items included in other (income) expenses, net, in 2012, 2011 or 2010.

### EARNINGS BEFORE INTEREST AND TAXES (EBIT)

The Company evaluates the performance of its operating segments based on EBIT, which the Company defines as earnings before interest and taxes. EBIT on a consolidated basis is a non-GAAP financial measure. However, the Company believes that EBIT provides investors and Management with a valuable and alternative method for assessing the Company's operating results. Management evaluates the performance of its operating segments based on EBIT and believes that EBIT is useful to investors to demonstrate the operational profitability

## MANAGEMENT'S DISCUSSION AND ANALYSIS

of the Company's business segments by excluding interest and taxes, which are generally accounted for across the entire company on a consolidated basis. EBIT is also one of the measures Management uses to determine resource allocations and incentive compensation.

EBIT (Dollars in millions)	Fiscal year ended			Change 2012 vs. 2011	Change 2011 vs. 2010
	2012	2011	2010		
USG	<b>\$46.2</b>	54.3	67.4	<b>(14.9)%</b>	(19.4)%
% of net sales	<b>14.5%</b>	15.5%	19.4%		
Test	<b>14.0</b>	18.6	12.2	<b>(24.7)%</b>	52.5 %
% of net sales	<b>8.0%</b>	10.5%	8.8%		
Filtration	<b>38.0</b>	30.8	19.5	<b>23.4 %</b>	57.9 %
% of net sales	<b>19.5%</b>	18.4%	16.1%		
Corporate	<b>(24.2)</b>	(24.2)	(25.5)	<b>— %</b>	(5.1)%
Total	<b>\$74.0</b>	79.5	73.6	<b>(6.9)%</b>	8.0 %
% of net sales	<b>10.8%</b>	11.5%	12.1%		

The reconciliation of EBIT to a GAAP financial measure is as follows:

(Dollars in millions)	2012	2011	2010
EBIT	<b>\$74.0</b>	79.5	73.6
Less: Interest expense	<b>(2.3)</b>	(2.5)	(4.0)
Less: Income taxes	<b>(24.8)</b>	(24.5)	(24.8)
Net earnings	<b>\$46.9</b>	52.5	44.8

### USG

The \$8.1 million decrease in EBIT in 2012 as compared to the prior year was due to Aclara's decrease in net sales due to the wind-down of certain projects, such as the CFE electric project, New York City water project and the PG&E gas project as mentioned above. EBIT was favorably impacted by a \$4.5 million gain related to the revaluation of the earnout liability related to the Xtensible acquisition.

The \$13.1 million decrease in EBIT in 2011 as compared to 2010 was due to: lower sales volumes of Aclara's STAR products at the PG&E gas project and New York City water project; partially offset by increases in EBIT due to increased sales volumes of Aclara's TWACS products and Doble's increase in sales. EBIT was negatively impacted by \$6.5 million in charges related to the write-down of certain Aclara inventory which was determined to be obsolete as next generation AMI products are currently being offered for sale. EBIT was favorably impacted by a \$7.6 million gain related to the revaluation of the earnout liability related to the Xtensible acquisition.

### Test

The \$4.6 million decrease in EBIT in 2012 as compared to the prior year was due to: a \$4 million decrease related to the segment's U.S. operations driven by lower sales volumes; a \$2.2 million decrease related to the segment's European operations driven by project delays and unexpected turnover of key employees in Germany, and additional investments in SG&A; partially offset by a \$1.5 million increase from the segment's Asian operations due to higher sales volumes.

The \$6.4 million increase in EBIT in 2011 as compared to 2010 was due to: an increase of \$4.8 million related to the segment's U.S. operations driven by the higher sales volumes; and a \$1.6 million increase related to the segment's European and Asian operations also driven by additional sales volumes as mentioned earlier.

### Filtration

EBIT increased \$7.2 million in 2012 as compared to the prior year mainly due to the additional sales volumes at all operating units within the segment as mentioned above.

EBIT increased \$11.3 million in 2011 as compared to 2010 mainly due to the additional sales volumes at VACCO, TEQ and PTI mentioned above as well as the full-year EBIT contribution from Crissair.

### Corporate

Corporate operating charges included in consolidated EBIT remained consistent at \$24.2 million in 2012 as compared to the prior year.

Corporate operating charges included in consolidated EBIT decreased \$1.3 million in 2011 as compared to 2010 mainly due to a decrease in transaction costs related to acquisition activity and lower professional fees.

The "Reconciliation to Consolidated Totals (Corporate)" in Note 13 to the Consolidated Financial Statements represents Corporate office operating charges.

### INTEREST EXPENSE, NET

Interest expense was \$2.3 million in 2012, \$2.5 million in 2011 compared to \$4 million in 2010, respectively. The decrease in interest expense in 2012 as compared to the prior year was due to: lower average interest rates (1.2% vs. 1.4%) and lower average outstanding borrowings (\$126 million vs. \$143 million), partially offset by a \$0.4 million increase due to the write-off of deferred financing costs related to the previous credit facility. The

decrease in interest expense in 2011 as compared to 2010 was due to lower average interest rates (1.4% vs. 1.9%) and lower average outstanding borrowings (\$143 million vs. \$171 million) under the revolving credit facility.

## INCOME TAX EXPENSE

The effective tax rate for fiscal years 2012, 2011 and 2010 was 34.6%, 31.8% and 35.6%, respectively. The increase in the 2012 effective tax rate as compared to the prior year was primarily due to: the December 31, 2011, expiration of the research tax credit which increased the 2012 effective tax rate by 1.6%; the repatriation of foreign subsidiary earnings which increased the 2012 effective tax rate by 0.9%; releasing a foreign valuation allowance which reduced the 2011 effective tax rate by 1.3%; a purchase accounting correction increased the 2012 effective tax rate by 0.7%; and the release of uncertain tax positions as a result of the lapse of statute of limitations reduced the 2012 effective tax rate by 2.5% and the 2011 effective tax rate by 0.5%.

The decrease in the 2011 effective tax rate as compared to 2010 was mainly due to: the extension of the research tax credit which reduced the 2011 effective tax rate by 2%; the release of uncertain tax positions as a result of the lapse of statute of limitations reduced the 2011 effective tax rate by 0.5%; and the beneficial effect of foreign tax rates reduced the 2011 effective tax rate by 0.7%.

The Company's foreign subsidiaries have accumulated unremitted earnings of \$34 million and cash of \$20.9 million at September 30, 2012. No deferred taxes have been provided on the accumulated unremitted earnings because these funds are not needed to meet the liquidity requirements of the Company's U.S. operations and it is the Company's intention to reinvest these earnings indefinitely. In the event these foreign entities' earnings were distributed, it is estimated that U.S. taxes, net of available foreign tax credits, of approximately \$5.6 million would be due, which would correspondingly reduce the Company's net earnings. No significant portion of the Company's foreign subsidiaries' earnings was taxed at a very low tax rate.

## Capital Resources and Liquidity

The Company's overall financial position and liquidity are strong. Working capital (current assets less current liabilities) increased to \$139.2 million at September 30, 2012, from \$122.5 million at September 30, 2011, due to higher accounts receivable and inventory balances.

The \$7 million increase in accounts receivable at September 30, 2012, was mainly due to: a \$15.7 million increase within the USG segment due to the timing of sales partially offset by an \$8.1 million decrease in the Test segment due to timing of collections. The \$11.1 million increase in inventory at September 30, 2012, was mainly due to: a \$7.8 million increase in the Filtration segment due to timing of sales and accelerated material receipts for various programs at VACCO; and a \$4.2 million increase in the USG segment.

Net cash provided by operating activities was \$53.2 million, \$75.9 million and \$67 million in 2012, 2011 and 2010, respectively. The decrease in 2012 as compared to the prior year was due to a decrease in net earnings and higher operating working capital requirements.

Capital expenditures were \$14.8 million, \$13.7 million and \$13.4 million in 2012, 2011 and 2010, respectively. The increase in 2012 as compared to 2011 was due to a \$1.1 million increase for manufacturing equipment within the Filtration segment. There were no commitments outstanding that were considered material for capital expenditures at September 30, 2012. In addition, the Company incurred expenditures for capitalized software of \$13.1 million, \$14.2 million and \$8.8 million in 2012, 2011 and 2010, respectively. The decrease in 2012 as compared to 2011 was mainly attributable to the Filtration segment's purchase of new ERP software. The increase in 2011 as compared to the prior years was primarily due to a \$3 million increase within the USG segment related to software development for new products.

The Company made required pension contributions of \$4.8 million, \$5.2 million and \$1.4 million in 2012, 2011 and 2010, respectively.

## ACQUISITIONS

### 2012

During 2012, the Company acquired a minority interest in Calico Energy, Inc. (Calico) for \$3.3 million in cash. Calico, headquartered in Seattle, Washington is a provider of demand response software used in smart grid deployments and will be offered in connection with Aclara's Smart Communications Network solution. This investment is accounted for under the cost method and is classified as a long-term Other asset on the Company's consolidated balance sheet at September 30, 2012.

### 2011

On February 28, 2011, the Company acquired the capital stock of EMV Elektronische Messgerate Vertriebs - GmbH, together

with its subsidiary EMSCREEN Electromagnetic Screening GmbH (collectively, EMV) for a purchase price of approximately \$5 million, inclusive of cash acquired. EMV, with operations in Taufkirchen, Germany, provides turnkey systems and shielded environments for research, development and quality assurance testing of electronic equipment. EMV's operating results, since the date of acquisition, are included within the Test segment and the Company recorded approximately \$4.8 million of goodwill as a result of the transaction.

## 2010

Effective July 31, 2010, the Company acquired the capital stock of Crissair, Inc. (Crissair) for a purchase price of approximately \$27 million, net of cash acquired. Crissair, headquartered in Palmdale, California, is a manufacturer of high-quality hydraulic, fuel and pneumatic system components for the aerospace industry. The operating results for Crissair, since the date of acquisition, are included within the Filtration segment. The Company recorded approximately \$9 million of goodwill as a result of the transaction, \$4.3 million of trade names and \$7.4 million of amortizable identifiable intangible assets consisting of customer relationships.

On September 3, 2010, the Company acquired the capital stock of Xtensible Solutions, Inc. (Xtensible) for a purchase price of approximately \$4 million in cash plus contingent consideration. Xtensible is a provider of information management and integration solutions to the utility industry worldwide and its operating results, since the date of acquisition until September 30, 2012, were included within Aclara in the USG segment. As of October 1, 2012, Xtensible's operating results will be included within Doble in the USG segment. The agreement includes contingent consideration based on target revenues to be paid out over the next three and one-half years from the date of acquisition. The Company recorded approximately \$15 million of goodwill as a result of the transaction. During 2012, the Company revalued the earnout obligation based on current forecasted revenues and recorded a \$4.5 million gain in Other (income) expenses, net.

All of the Company's acquisitions have been accounted for using the purchase method of accounting, and accordingly, the respective purchase prices were allocated to the assets (including intangible assets) acquired and liabilities assumed based on estimated fair values at the date of acquisition. The financial results from these acquisitions have been included in the Company's financial statements from the date of acquisition.

## BANK CREDIT FACILITY

At September 30, 2012, the Company had approximately \$320 million available to borrow under the credit facility, plus a \$250 million increase option, in addition to \$30.2 million cash on hand, for a total of approximately \$600 million. The Company classified \$50 million as the current portion of long-term debt as of September 30, 2012, as the Company intends to repay this amount within the next 12 months; however, the Company has no contractual obligation to repay such amount during the next twelve months. The Company's ability to access the additional \$250 million increase option of the credit facility is subject to acceptance by participating or other outside banks.

The credit facility requires, as determined by certain financial ratios, a facility fee ranging from 17.5 to 35.0 basis points per annum on the unused portion. The terms of the facility provide that interest on borrowings may be calculated at a spread over the London Interbank Offered Rate (LIBOR) or based on the prime rate, at the Company's election. The facility is secured by the unlimited guaranty of the Company's material domestic subsidiaries and a 65% pledge of the material foreign subsidiaries' share equity. The financial covenants of the credit facility include a leverage ratio and an interest coverage ratio. As of September 30, 2012, the Company was in compliance with all bank covenants.

Cash flow from operations and borrowings under the bank credit facility are expected to provide adequate resources to meet the Company's capital requirements and operational needs for the foreseeable future.

## DIVIDENDS

During 2010, the Company initiated a quarterly cash dividend payable at an annual rate of \$0.32 per share. The Company paid dividends of \$8.6 million, \$8.5 million and \$6.3 million in 2012, 2011 and 2010, respectively.

## OUTLOOK — 2013

Management continues to see strong growth in 2013 across the business. Based on projected revenue growth of approximately 10 percent, Management expects 2013 operational EPS in the range of \$2.30 to \$2.50 per share, which excludes non-recurring restructuring charges described below. In addition, the 2013 effective tax rate is projected to be approximately 35%. On a quarterly basis, Management expects 2013 revenues and EPS to be more second-half weighted, with first quarter EPS being less than \$0.10 per share. The Company plans to

consolidate the Test segment's four domestic manufacturing facilities into three domestic locations, resulting in the closure of the Glendale Heights, Illinois, facility. The non-recurring restructuring costs are expected to be approximately \$3 million and will be expensed over the first six months of 2013.

#### CONTRACTUAL OBLIGATIONS

The following table shows the Company's contractual obligations as of September 30, 2012:

(Dollars in millions)	Payments due by period				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Long-Term Debt Obligation	\$115.0	—	—	115.0	—
Estimated Interest Payments <sup>(1)</sup>	3.8	1.8	2.0	—	—
Operating Lease Obligations	24.0	7.6	10.9	5.0	0.5
Purchase Obligations <sup>(2)</sup>	13.2	13.1	0.1	—	—
Total	\$156.0	22.5	13.0	120.0	0.5

<sup>(1)</sup> Estimated interest payments for the Company's debt obligations were calculated based on Management's determination of the estimated applicable interest rates and payment dates.

<sup>(2)</sup> A purchase obligation is defined as a legally binding and enforceable agreement to purchase goods and services that specifies all significant terms. Since the majority of the Company's purchase orders can be cancelled, they are not included in the table above.

As of September 30, 2012, the Company had \$1.8 million of liabilities for uncertain tax positions. The unrecognized tax benefits have been excluded from the table above due to uncertainty as to the amounts and timing of settlement with taxing authorities.

The Company has no off-balance-sheet arrangements outstanding at September 30, 2012.

#### SHARE REPURCHASES

In August 2012, the Company's Board of Directors authorized an expanded stock repurchase program whereby Management may repurchase shares of its outstanding common stock in the open market and otherwise throughout the period ending September 30, 2013. The total value authorized is the lesser of \$100 million, or the dollar limitation imposed by Section 6.07 of the Company's Credit Agreement dated May 14, 2012. The previous authorization was set to expire September 30, 2012.

During the fourth quarter of 2012, the Company repurchased \$5.4 million or approximately 150,000 shares. Subsequent to fiscal year-end, the Company spent an additional \$9.7 million to repurchase approximately 270,000 shares. There were no stock repurchases during 2011 or 2010.

#### PENSION FUNDING REQUIREMENTS

The minimum cash funding requirements related to the Company's defined benefit pension plans are estimated to be approximately \$2.5 million in 2013, approximately \$3.5 million in 2014 and approximately \$3 million in 2015.

#### OTHER

Management believes that, for the periods presented, inflation has not had a material effect on the Company's results of operations.

The Company is currently involved in various stages of investigation and remediation relating to environmental matters. Based on current information available, Management does not believe the aggregate costs involved in the resolution of these matters will have a material adverse effect on the Company's operating results, capital expenditures or competitive position.

#### Market Risk Analysis

##### MARKET RISK EXPOSURE

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign currency exchange rates. The Company is exposed to market risk related to changes in interest rates and selectively uses derivative financial instruments, including forward contracts and swaps, to manage these risks. All derivative instruments are reported on the balance sheet at fair value. The derivative instrument is designated as a cash flow hedge and the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. There were no outstanding derivative instruments at September 30, 2012. The Company has determined that the market risk related to interest rates with respect to its variable debt is not material. The Company estimates that if market interest rates averaged one percentage point higher, the effect would have been less than 2% of net earnings for the year ended September 30, 2012.

The Company is also subject to foreign currency exchange rate risk inherent in its sales commitments, anticipated sales, anticipated purchases and assets and liabilities denominated

in currencies other than the U.S. dollar. The foreign currency most significant to the Company's operations is the Euro. Net sales to customers outside of the United States were \$186.5 million, \$181.3 million, and \$141.4 million in 2012, 2011 and 2010, respectively. The Company hedges certain foreign currency commitments by purchasing foreign currency forward contracts. The Company does not have material foreign currency market risk (e.g. net foreign currency transaction gain/loss was less than 2% of net earnings for fiscal years 2012, 2011 and 2010).

### Critical Accounting Policies

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires Management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying Consolidated Financial Statements. In preparing these financial statements, Management has made its best estimates and judgments of certain amounts included in the Consolidated Financial Statements, giving due consideration to materiality. The Company does not believe there is a great likelihood that materially different amounts would be reported under different conditions or using different assumptions related to the accounting policies described below. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, as a result, actual results could differ from these estimates. The Company's senior Management discusses the critical accounting policies described below with the Audit and Finance Committee of the Company's Board of Directors on a periodic basis.

The following discussion of critical accounting policies is intended to bring to the attention of readers those accounting policies which Management believes are critical to the Consolidated Financial Statements and other financial disclosure. It is not intended to be a comprehensive list of all significant accounting policies that are more fully described in Note 1 of Notes to Consolidated Financial Statements.

### REVENUE RECOGNITION

**USG Segment:** Within the USG segment, approximately 65% of the segment's revenue arrangements (approximately 30% of consolidated revenues) contain software components and/or multiple element arrangements. The application of these standards requires judgment, including the determination of whether an arrangement includes multiple elements and

estimates of the fair value of the elements, using vendor-specific objective evidence of fair value (VSOE), if it exists, otherwise third-party evidence (TPE) or estimated selling price (ESP). Changes to the elements in an arrangement, and the ability to identify fair value for those elements could materially impact the amount of earned and/or deferred revenue. There have been no material changes to these estimates for the financial statement periods presented and the Company believes that these estimates generally should not be subject to significant variation in the future. The remaining 35% of the segment's revenues (approximately 15% of consolidated revenues) represent products sold under a single element arrangement and are recognized when products are delivered (when title and risk of ownership transfers), when services are performed for unaffiliated customers or on a straight-line basis over the lease term.

**Test Segment:** Within the Test segment, approximately 40% of revenues (approximately 10% of consolidated revenues) are recognized when products are delivered (when title and risk of ownership transfers) or when services are performed for unaffiliated customers. Certain arrangements contain multiple elements and the application of the guidance requires judgment as to whether the deliverables can be divided into more than one unit of accounting and whether the separate units of accounting have value to the customer on a stand-alone basis. Changes to these elements could affect the timing of revenue recognition. There have been no material changes to these elements for the financial statement periods presented.

Approximately 60% of the segment's revenues (approximately 15% of consolidated revenues) are recorded under the percentage-of-completion method due to the complex nature of the enclosures that are designed and produced under these contracts. As discussed above, this method of accounting involves the use of various estimating techniques to project costs at completion, which are based on Management's judgment and the Company's substantial experience in developing these types of estimates. Changes in underlying assumptions/estimates may adversely or positively affect financial performance in a period. Due to the nature of these contracts and the operating unit's cost estimating process, the Company believes that these estimates generally should not be subject to significant variation in the future. There have been no material changes to these estimates for the financial statement periods presented. The Company regularly reviews its contract estimates to assess revisions in contract values and estimated costs at completion.

**Filtration Segment:** Within the Filtration segment, approximately 65% of segment revenues (approximately 20% of consolidated revenues) are recognized when products are delivered (when title and risk of ownership transfers) or when services are performed for unaffiliated customers.

Approximately 35% of segment revenues (approximately 10% of consolidated revenues) are recorded under the percentage-of-completion provisions because the Company manufactures complex products for aerospace and military customers under production contracts. The percentage-of-completion method of accounting involves the use of various estimating techniques to project costs at completion. These estimates involve various assumptions and projections relative to the outcome of future events over a period of several years, including future labor productivity and availability, the nature and complexity of the work to be performed, availability of materials, the impact of delayed performance, and the timing of product deliveries. These estimates are based on Management's judgment and the Company's substantial experience in developing these types of estimates. Changes in underlying assumptions/estimates may adversely affect financial performance if they increase estimated project costs at completion, or positively affect financial performance if they decrease estimated project costs at completion. Due to the nature of these contracts and the operating unit's cost estimating process, the Company believes that these estimates generally should not be subject to significant variation in the future. There have been no material changes to these estimates for the financial statement periods presented. The Company regularly reviews its estimates to assess revisions in contract values and estimated costs at completion.

## INVENTORY

Inventories are valued at the lower of cost (first-in, first-out) or market value. Management regularly reviews inventories on hand compared to historical usage and estimated future usage and sales. Inventories under long-term contracts reflect accumulated production costs, factory overhead, initial tooling and other related costs less the portion of such costs charged to cost of sales and any unliquidated progress payments. In accordance with industry practice, costs incurred on contracts in progress include amounts relating to programs having production cycles longer than one year, and a portion thereof may not be realized within one year.

## INCOME TAXES

The Company operates in numerous taxing jurisdictions and is subject to examination by various U.S. Federal, state and foreign jurisdictions for various tax periods. Additionally, the Company has retained tax liabilities and the rights to tax refunds in connection with various divestitures of businesses in prior years. The Company's income tax positions are based on research and interpretations of the income tax laws and rulings in each of the jurisdictions in which the Company does business. Due to the subjectivity of interpretations of laws and rulings in each jurisdiction, the differences and interplay in tax laws between those jurisdictions, as well as the inherent uncertainty in estimating the final resolution of complex tax audit matters, Management's estimates of income tax liabilities may differ from actual payments or assessments.

Management regularly assesses the Company's position with regard to tax exposures and records liabilities for these uncertain tax positions and related interest and penalties, if any, according to the principles of Financial Accounting Standards Board (FASB) ASC Topic 740, *Income Taxes* (ASC 740). The Company has recorded an accrual that reflects the recognition and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return based upon ASC 740. Additional future income tax expense or benefit may be recognized once the positions are effectively settled. It is the Company's policy to follow FASB ASC 740-10-45-20 and record the tax effects of changes in the opening balance of unrecognized tax benefits in net earnings from continuing operations.

At the end of each interim reporting period, Management estimates the effective tax rate expected to apply to the full fiscal year. The estimated effective tax rate contemplates the expected jurisdiction where income is earned, as well as tax planning strategies. Current and projected growth in income in higher tax jurisdictions may result in an increasing effective tax rate over time. If the actual results differ from Management's estimates, Management may have to adjust the effective tax rate in the interim period if such determination is made.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates

expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets may be reduced by a valuation allowance if it is more likely than not that some portion of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company regularly reviews its deferred tax assets for recoverability and establishes a valuation allowance when Management believes it is more likely than not such assets will not be recovered, taking into consideration historical operating results, expectations of future earnings, tax planning strategies, and the expected timing of the reversals of existing temporary differences.

#### **GOODWILL AND OTHER LONG-LIVED ASSETS**

Management annually reviews goodwill and other long-lived assets with indefinite useful lives for impairment or whenever events or changes in circumstances indicate the carrying amount may not be recoverable. If the Company determines that the carrying value of the long-lived asset may not be recoverable, a permanent impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value. Fair value is measured based on a discounted cash flow method using a discount rate determined by Management to be commensurate with the risk inherent in the Company's current business model. The estimates of cash flows and discount rate are subject to change due to the economic environment, including such factors as interest rates, expected market returns and volatility of markets served. Management believes that the estimates of future cash flows and fair value are reasonable; however, changes in estimates could result in impairment charges. At September 30, 2012, the Company has determined that no reporting units are at risk of material goodwill impairment as the fair value of each reporting unit substantially exceeded its carrying value. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed annually for impairment.

#### **PENSION PLANS AND OTHER POSTRETIREMENT BENEFIT PLANS**

The measurement of liabilities related to pension plans and other postretirement benefit plans is based on Management's assumptions related to future events including interest rates, return on pension plan assets, and health care cost trend rates. Actual pension plan asset performance will either decrease

or increase unamortized pension losses/gains that will affect net earnings in future years. Depending upon the performance of the equity and bond markets in 2013, the Company could be required to record a charge to equity. In addition, if the discount rate was decreased by 25 basis points from 3.75% to 3.5%, the projected benefit obligation for the defined benefit plan would increase by approximately \$3 million and result in an additional after-tax charge to shareholders' equity of approximately \$1.9 million. The discount rate used in measuring the Company's pension and postretirement welfare obligations was developed by matching yields of actual high-quality corporate bonds to expected future pension plan cash flows (benefit payments). Over 400 Aa-rated, non-callable bonds with a wide range of maturities were used in the analysis. After using the bond yields to determine the present value of the plan cash flows, a single representative rate that resulted in the same present value was developed.

#### **Other Matters**

##### **CONTINGENCIES**

As a normal course of business in which the Company is engaged, various claims, charges and litigation are asserted or commenced against the Company. With respect to claims and litigation asserted or commenced against the Company, it is the opinion of Management that final judgments, if any, which might be rendered against the Company are adequately reserved or covered by insurance, or are not likely to have a material adverse effect on its financial condition or results of operation.

##### **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign currency exchange rates. The Company is exposed to market risk related to changes in interest rates and selectively uses derivative financial instruments, including forward contracts and swaps, to manage these risks. All derivative instruments are reported on the balance sheet at fair value. The derivative instrument is designated as a cash flow hedge and the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. There were no outstanding derivative instruments at September 30, 2012. See further discussion in "Management's Discussion and Analysis — Market Risk Analysis" regarding the Company's market risks.

### CONTROLS AND PROCEDURES

The Company carried out an evaluation under the supervision of and with the participation of Management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There have been no significant changes in the Company's internal controls or in other factors during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### New Accounting Pronouncements

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). This ASU updates the rules on testing indefinite-lived intangible assets other than goodwill for impairment and permits the option to perform a qualitative assessment of the fair value of indefinite-lived intangible assets. This update is effective for fiscal years, and interim periods within those years, beginning after September 15, 2012, and is not expected to have a material impact on the Company's financial statements.

### Forward-Looking Information

Statements regarding future events and the Company's future results that are based on current expectations, estimates, forecasts and projections about the Company's performance and the industries in which the Company operates, the amount and timing of 2013 revenues and EPS, adequacy of the Company's credit facilities and future cash flows, the anticipated size of SoCalGas' deployment, the outcome of current litigation, claims and charges, the anticipated timing and amount of lost deferred tax assets, continued reinvestment of foreign earnings, the accuracy of the Company's estimates utilized in software revenue recognition, the accuracy of the Company's estimates utilized to project costs at completion

in the Test segment and Filtration segment, income tax liabilities, the effective tax rate, the timing and amount of the reduction of unrecognized tax benefits, repayment of debt within the next 12 months, the recognition of costs related to share-based compensation arrangements, future costs relating to environmental matters, share repurchases, investments, sustained performance improvement, market risk related to interest rates, the impact of FASB Update No. 2012-02, performance improvement initiatives, growth opportunities, new product development, the Company's ability to increase shareholder value, acquisitions, and the beliefs and assumptions of Management contained in the letter To Our Shareholders (pages 1-3), and Management's Discussion and Analysis and other statements contained herein which are not strictly historical are considered "forward-looking statements" within the meaning of the safe harbor provisions of the Federal securities laws. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, estimates, variations of such words, and similar expressions are intended to identify such forward-looking statements. Investors are cautioned that such statements are only predictions, speak only as of the date of this report, and the Company undertakes no duty to update. The Company's actual results in the future may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the Company's operations and business environment including, but not limited to those described under "Item 1A. Risk Factors" in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2012, and the following: changes in requirements or financial constraints impacting SoCalGas; the impacts of natural disasters such as hurricanes on the Company's operations and those of the Company's customers and suppliers; the timing and content of future customer orders; termination for convenience of customer contracts; timing and magnitude of future contract awards; weakening of economic conditions in served markets; the success of the Company's competitors; changes in customer demands or customer insolvencies; competition; intellectual property rights; technical difficulties; the availability of selected acquisitions; delivery delays or defaults by customers; performance issues with key customers, suppliers and subcontractors; material changes in the costs of certain raw materials; labor disputes; changes in laws and regulations including but not limited to changes in accounting standards and taxation requirements; costs relating to environmental matters; litigation uncertainty; and the Company's successful execution of internal restructuring plans.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in thousands, except per share amounts)

Years ended September 30,

	2012	2011	2010
Net sales	\$ 688,403	693,711	607,493
Costs and expenses:			
Cost of sales	418,879	424,846	361,942
Selling, general and administrative expenses	186,079	182,530	157,348
Amortization of intangible assets	13,322	11,982	11,633
Interest expense, net	2,340	2,493	3,977
Other (income) expenses, net	(3,901)	(5,098)	2,928
Total costs and expenses	616,719	616,753	537,828
Earnings before income tax	71,684	76,958	69,665
Income tax expense	24,805	24,457	24,819
Net earnings	\$ 46,879	52,501	44,846
Earnings per share:			
Basic:			
Net earnings	\$1.76	1.97	1.70
Diluted:			
Net earnings	1.73	1.95	1.68
Average common shares outstanding (in thousands):			
Basic	26,699	26,588	26,450
Diluted	27,030	26,903	26,738

See accompanying Notes to Consolidated Financial Statements.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

Years ended September 30,

2012

2011

### ASSETS

#### Current assets:

Cash and cash equivalents	\$ 30,215	34,158
Accounts receivable, less allowance for doubtful accounts of \$1,927 and \$2,044 in 2012 and 2011, respectively	151,051	144,083
Costs and estimated earnings on long-term contracts, less progress billings of \$30,534 and \$11,416 in 2012 and 2011, respectively	14,567	12,974
Inventories	108,061	96,986
Current portion of deferred tax assets	22,313	20,630
Other current assets	17,237	19,523
Total current assets	343,444	328,354

#### Property, plant and equipment:

Land and land improvements	4,984	4,986
Buildings and leasehold improvements	53,278	52,648
Machinery and equipment	93,663	85,440
Construction in progress	5,135	2,779
	157,060	145,853
Less accumulated depreciation and amortization	81,184	72,786
Net property, plant and equipment	75,876	73,067

Intangible assets, net	231,473	231,848
Goodwill	361,280	361,864
Other assets	21,680	16,704
Total Assets	\$1,033,753	1,011,837

See accompanying Notes to Consolidated Financial Statements.

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)  
Years ended September 30,

2012

2011

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current liabilities:

Current maturities of long-term debt	\$ 50,000	50,000
Accounts payable	54,049	54,037
Advance payments on long-term contracts, less costs incurred of \$31,534 and \$30,925 in 2012 and 2011, respectively	21,700	23,667
Accrued salaries	25,717	26,040
Current portion of deferred revenue	24,920	24,499
Accrued other expenses	27,819	27,594
Total current liabilities	204,205	205,837

Pension obligations	35,480	33,439
Deferred tax liabilities	88,675	85,313
Other liabilities	9,080	11,538
Long-term debt	65,000	75,000
Total liabilities	402,440	411,127

#### Shareholders' equity:

Preferred stock, par value \$.01 per share, authorized 10,000,000 shares	—	—
Common stock, par value \$.01 per share, authorized 50,000,000 shares; Issued 30,044,486 and 29,956,904 shares in 2012 and 2011, respectively	300	300
Additional paid-in capital	279,392	275,807
Retained earnings	441,566	403,241
Accumulated other comprehensive loss, net of tax	(25,378)	(19,191)
	695,880	660,157
Less treasury stock, at cost (3,453,249 and 3,320,926 common shares in 2012 and 2011, respectively)	(64,567)	(59,447)
Total shareholders' equity	631,313	600,710
Total Liabilities and Shareholders' Equity	\$ 1,033,753	1,011,837

See accompanying Notes to Consolidated Financial Statements.

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
	Shares	Amount					
Balance, September 30, 2009	29,771	\$298	265,794	322,878	(11,598)	(60,032)	517,340
Comprehensive income:							
Net earnings	—	—	—	44,846	—	—	44,846
Translation adjustments	—	—	—	—	(1,557)	—	(1,557)
Net unrecognized actuarial loss, net of tax of \$1,422	—	—	—	—	(2,234)	—	(2,234)
Interest rate swap, net of tax of \$(385)	—	—	—	—	596	—	596
Comprehensive income							41,651
Cash dividends declared (\$0.32 per share)	—	—	—	(8,450)	—	—	(8,450)
Stock options and stock compensation plans, net of tax benefit of \$(105)	68	—	5,149	—	—	292	5,441
Balance, September 30, 2010	29,839	298	270,943	359,274	(14,793)	(59,740)	555,982
Comprehensive income:							
Net earnings	—	—	—	52,501	—	—	52,501
Translation adjustments	—	—	—	—	(333)	—	(333)
Net unrecognized actuarial loss, net of tax of \$2,689	—	—	—	—	(4,354)	—	(4,354)
Interest rate swap, net of tax of \$(187)	—	—	—	—	289	—	289
Comprehensive income							48,103
Cash dividends declared (\$0.32 per share)	—	—	—	(8,534)	—	—	(8,534)
Stock options and stock compensation plans, net of tax benefit of \$(55)	118	2	4,864	—	—	293	5,159
Balance, September 30, 2011	29,957	300	275,807	403,241	(19,191)	(59,447)	600,710
Comprehensive income:							
Net earnings	—	—	—	46,879	—	—	46,879
Translation adjustments	—	—	—	—	(2,018)	—	(2,018)
Net unrecognized actuarial loss, net of tax of \$2,769	—	—	—	—	(4,171)	—	(4,171)
Interest rate swap, net of tax of \$(1)	—	—	—	—	2	—	2
Comprehensive income							40,692
Cash dividends declared (\$0.32 per share)	—	—	—	(8,554)	—	—	(8,554)
Stock options and stock compensation plans, net of tax benefit of \$(123)	87	—	3,585	—	—	283	3,868
Purchases into treasury	—	—	—	—	—	(5,403)	(5,403)
Balance, September 30, 2012	30,044	\$300	279,392	441,566	(25,378)	(64,567)	631,313

See accompanying Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)			
Years ended September 30,	2012	2011	2010
Cash flows from operating activities:			
Net earnings	\$ 46,879	52,501	44,846
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	24,782	23,521	22,137
Stock compensation expense	4,602	4,670	4,558
Changes in current assets and liabilities	(17,614)	(1,542)	(9,615)
Effect of deferred taxes on tax provision	4,381	3,551	4,059
Change in acquisition earnout obligation	(4,459)	(7,595)	—
Pension contributions	(4,800)	(5,230)	(1,368)
Change in deferred revenue and costs, net	549	2,565	329
Amortization of prepaid debt fees	1,030	772	257
Change in uncertain tax positions	(1,738)	294	765
Other	(448)	2,359	1,055
Net cash provided by operating activities	53,164	75,866	67,023
Cash flows from investing activities:			
Acquisition of businesses, net of cash acquired	(3,345)	(4,982)	(32,316)
Change in restricted cash (acquisition escrow)	1,367	1,361	2,041
Capital expenditures	(14,754)	(13,709)	(13,438)
Additions to capitalized software	(13,080)	(14,151)	(8,827)
Net cash used by investing activities	(29,812)	(31,481)	(52,540)
Cash flows from financing activities:			
Proceeds from long-term debt	192,455	49,370	40,000
Principal payments on long-term debt	(202,455)	(78,370)	(66,467)
Dividends paid	(8,554)	(8,534)	(6,335)
Purchases of shares into treasury	(5,403)	—	—
Deferred financing costs	(1,937)	—	—
Other	617	1,132	1,755
Net cash used by financing activities	(25,277)	(36,402)	(31,047)
Effect of exchange rate changes on cash and cash equivalents	(2,018)	(333)	(1,558)
Net (decrease) increase in cash and cash equivalents	(3,943)	7,650	(18,122)
Cash and cash equivalents at beginning of year	34,158	26,508	44,630
Cash and cash equivalents at end of year	\$ 30,215	34,158	26,508
Changes in current assets and liabilities:			
Accounts receivable, net	\$ (6,968)	(1,786)	(27,960)
Costs and estimated earnings on long-term contracts, net	(1,593)	(231)	(1,985)
Inventories	(11,075)	(12,459)	5,926
Other assets	4,075	35	(2,397)
Accounts payable	12	(6,118)	10,597
Advance payments on long-term contracts, net	(1,967)	17,938	2,889
Accrued expenses	(98)	1,079	3,315
	\$ (17,614)	(1,542)	(9,615)
Supplemental cash flow information:			
Interest paid	\$ 1,588	1,959	3,536
Income taxes paid (including state & foreign)	16,544	21,895	21,378

See accompanying Notes to Consolidated Financial Statements.

## 1. Summary of Significant Accounting Policies

### A. PRINCIPLES OF CONSOLIDATION

The Consolidated Financial Statements include the accounts of ESCO Technologies Inc. (ESCO) and its wholly owned subsidiaries (the Company). All significant intercompany transactions and accounts have been eliminated in consolidation.

### B. BASIS OF PRESENTATION

Fair values of the Company's financial instruments are estimated by reference to quoted prices from market sources and financial institutions, as well as other valuation techniques. The estimated fair value of each class of financial instruments approximated the related carrying value at September 30, 2012, and 2011.

### C. NATURE OF OPERATIONS

The Company has three reportable segments: Utility Solutions Group (USG), RF Shielding and Test (Test), and Filtration/Fluid Flow (Filtration).

**USG:** Aclara is a proven supplier of special purpose fixed-network communications systems for electric, gas and water utilities, including hardware and software to support advanced metering applications. Doble provides high-end, intelligent, diagnostic test solutions for the electric power delivery industry.

**Test:** The EMC Group is an industry leader in providing its customers with the ability to identify, measure and contain magnetic, electromagnetic and acoustic energy.

**Filtration:** The companies within this segment primarily design and manufacture specialty filtration products including hydraulic filter elements used in commercial aerospace applications, unique filter mechanisms used in micro-propulsion devices for satellites and custom designed filters for manned aircraft and submarines.

### D. USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The Company

regularly evaluates the estimates and assumptions related to the allowance for doubtful trade receivables, inventory obsolescence, warranty reserves, value of equity-based awards, goodwill and purchased intangible asset valuations, asset impairments, employee benefit plan liabilities, income tax liabilities and assets and related valuation allowances, uncertain tax positions, estimates on long-term contracts, and litigation and other loss contingencies. Actual results could differ from those estimates.

### E. REVENUE RECOGNITION

**USG Segment:** Within the USG segment, approximately 65% of the segment's revenue arrangements (approximately 30% of consolidated revenues) contain software components and/or multiple element arrangements. These revenue arrangements are divided into separate units of accounting if the delivered item(s) has value to the customer on a stand-alone basis, there is objective and reliable evidence of the fair value of the undelivered item(s) and delivery/performance of the undelivered item(s) is probable. The segment's revenue arrangements within Aclara generally include multiple products and services, or "elements" consisting of meter and substation hardware, meter reading system software, program management support during the deployment period and software support (post-contract customer support or "PCS"). These arrangements typically require the Company to deliver software at the inception of the arrangement while the hardware and program management support are delivered over the contractual deployment period. Software support is provided during deployment and subsequent thereto. The Company allocates consideration to each deliverable in an arrangement based on its relative selling price. When arrangements have both software and non-software elements, the Company allocates consideration to each element using vendor-specific objective evidence (VSOE), if it exists, otherwise third-party evidence (TPE) is utilized. If neither VSOE nor TPE of selling price exists for a unit of accounting, the Company uses estimated selling price (ESP). The VSOE of the fair value of undelivered elements is determined based on the historical evidence of stand-alone sales of these elements to customers or, if applicable, the stated renewal rate in the agreement. TPE is determined by the prices charged by the Company's competitors for a similar deliverable when sold separately. The objective of ESP is to determine the price at which the Company would transact if the product or service were sold on a stand-alone basis. The application of these

principles requires judgment, including the determination of whether a software arrangement includes multiple elements and estimates of the fair value of the elements.

Hardware is considered a specified element in the software arrangement and VSOE has been established for this element. VSOE for the hardware element is determined based on the price when sold separately to customers. Hardware revenues are generally recognized at the time of shipment or receipt by customer depending upon contract terms. VSOE generally does not exist for the software element; therefore, the Company uses TPE or ESP based on the number of endpoints. The Company has established VSOE for the PCS element by a consistent pricing of PCS and PCS renewals as a percentage of the software license fees or by reference to contractual renewals, when the renewal terms are substantive. Revenues for PCS are recognized ratably over the maintenance term specified in the contract (generally in 12 monthly increments). Revenues for program management support are recognized when services have been provided. The Company determines VSOE for program management support based on hourly rates when services are performed separately. Approximately 35% of segment revenues (approximately 15% of consolidated revenues) are recognized when products are delivered (when title and risk of ownership transfers), when services are performed for unaffiliated customers or on a straight-line basis over the lease term.

**Test Segment:** Within the Test segment, approximately 40% of revenues (approximately 10% of consolidated revenues) are recognized when products are delivered (when title and risk of ownership transfers) or when services are performed for unaffiliated customers. Certain arrangements contain multiple elements generally consisting of materials and installation services used in the construction and installation of standard shielded enclosures to measure and contain magnetic and electromagnetic energy. The installation process does not involve changes to the features or capabilities of the equipment and does not require proprietary information about the equipment in order for the installed equipment to perform to specifications. There is objective and reliable evidence of fair value for each of the units of accounting, and, as a result, the arrangement revenue is allocated to the separate units of accounting based on their relative fair values. Typically, fair value is the price of the deliverable when it is regularly sold on a stand-alone basis.

Approximately 60% of the segment's revenues (approximately 15% of consolidated revenues) are recorded under the percentage-of-completion method due to the complex nature of the enclosures that are designed and produced under these contracts. Products accounted for under this guidance include the construction and installation of complex test chambers to a buyer's specifications that provide its customers with the ability to measure and contain magnetic, electromagnetic and acoustic energy. As discussed above, for arrangements that are accounted for under this guidance, the Company estimates profit as the difference between total estimated revenue and total estimated cost of a contract and recognizes these revenues and costs based on either (a) units delivered or (b) contract milestones. If a reliable measure of output cannot be established (which applies in less than 10% of Test segment revenues or 2% of consolidated revenues), input measures (e.g., costs incurred) are used to recognize revenue. Given the nature of the Company's operations related to these contracts, costs incurred represent an appropriate measure of progress towards completion.

The percentage-of-completion method of accounting involves the use of various techniques to estimate expected costs at completion. These estimates are based on Management's judgment and the Company's substantial experience in developing these types of estimates.

**Filtration Segment:** Within the Filtration segment, approximately 65% of revenues (approximately 20% of consolidated revenues) are recognized when products are delivered (when title and risk of ownership transfers) or when services are performed for unaffiliated customers.

Approximately 35% of segment revenues (approximately 10% of consolidated revenues) are recorded under the percentage-of-completion method. Products accounted for under this guidance include the design, development and manufacture of complex fluid control products, quiet valves, manifolds and systems primarily for the aerospace and military markets. For arrangements that are accounted for under this guidance, the Company estimates profit as the difference between total estimated revenue and total estimated cost of a contract and recognizes these revenues and costs based on units delivered. The percentage-of-completion method of accounting involves the use of various techniques to estimate expected costs at completion.

## F. CASH AND CASH EQUIVALENTS

Cash equivalents include temporary investments that are readily convertible into cash, such as money market funds.

## G. ACCOUNTS RECEIVABLE

Accounts receivable have been reduced by an allowance for amounts that the Company estimates are uncollectible in the future. This estimated allowance is based on Management's evaluation of the financial condition of the customer and historical write-off experience.

## H. COSTS AND ESTIMATED EARNINGS ON LONG-TERM CONTRACTS

Costs and estimated earnings on long-term contracts represent unbilled revenues, including accrued profits, accounted for under the percentage-of-completion method, net of progress billings.

## I. INVENTORIES

Inventories are valued at the lower of cost (first-in, first-out) or market value. Inventories are regularly reviewed for excess quantities and obsolescence based upon historical experience, specific identification of discontinued items, future demand, and market conditions. Inventories under long-term contracts reflect accumulated production costs, factory overhead, initial tooling and other related costs less the portion of such costs charged to cost of sales and any unliquidated progress payments.

## J. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost. Depreciation and amortization are computed primarily on a straight-line basis over the estimated useful lives of the assets: buildings, 10-40 years; machinery and equipment, 3-10 years; and office furniture and equipment, 3-10 years. Leasehold improvements are amortized over the remaining term of the applicable lease or their estimated useful lives, whichever is shorter. Long-lived tangible assets are reviewed for impairment whenever events or changes in business circumstances indicate the carrying value of the assets may not be recoverable. Impairment losses are recognized based on fair value.

## K. GOODWILL AND OTHER LONG-LIVED ASSETS

Goodwill represents the excess of purchase costs over the fair value of net identifiable assets acquired in business acquisitions. Management annually reviews goodwill and other long-lived assets with indefinite useful lives for impairment or whenever events or changes in circumstances indicate

the carrying amount may not be recoverable. If the Company determines that the carrying value of the long-lived asset may not be recoverable, a permanent impairment charge is recorded for the amount by which the carrying value of the long-lived asset exceeds its fair value.

Fair value is measured based on a discounted cash flow method using a discount rate determined by Management to be commensurate with the risk inherent in the Company's current business model. Other intangible assets represent costs allocated to identifiable intangible assets, principally capitalized software, patents, trademarks, and technology rights. See Note 3 regarding goodwill and other intangible assets activity.

## L. CAPITALIZED SOFTWARE

The costs incurred for the development of computer software that will be sold, leased, or otherwise marketed are charged to expense when incurred as research and development until technological feasibility has been established for the product. Technological feasibility is typically established upon completion of a detailed program design. Costs incurred after this point are capitalized on a project-by-project basis in accordance with FASB ASC Topic 985, *Software*. Capitalized costs consist of internal and external development costs. Upon general release of the product to customers, the Company ceases capitalization and begins amortization, which is calculated on a project-by-project basis as the greater of (1) the ratio of current gross revenues for a product to the total of current and anticipated future gross revenues for the product or (2) the straight-line method over the estimated economic life of the product. The Company generally amortizes the software development costs over a three-to-ten year period based upon the estimated future economic life of the product. Factors considered in determining the estimated future economic life of the product include anticipated future revenues, and changes in software and hardware technologies. Management annually reviews the carrying values of capitalized costs for impairment or whenever events or changes in circumstances indicate the carrying amount may not be recoverable. If expected cash flows are insufficient to recover the carrying amount of the asset, then an impairment loss is recognized to state the asset at its net realizable value.

## M. INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences

between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets may be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company regularly reviews its deferred tax assets for recoverability and establishes a valuation allowance when Management believes it is more likely than not such assets will not be recovered, taking into consideration historical operating results, expectations of future earnings, tax planning strategies, and the expected timing of the reversals of existing temporary differences.

#### N. RESEARCH AND DEVELOPMENT COSTS

Company-sponsored research and development costs include research and development and bid and proposal efforts related to the Company's products and services. Company-sponsored product development costs are charged to expense when incurred. Customer-sponsored research and development costs incurred pursuant to contracts are accounted for similarly to other program costs. Customer-sponsored research and development costs refer to certain situations whereby customers provide funding to support specific contractually defined research and development costs.

#### O. FOREIGN CURRENCY TRANSLATION

The financial statements of the Company's foreign operations are translated into U.S. dollars in accordance with FASB ASC Topic 830, *Foreign Currency Matters*. The resulting translation adjustments are recorded as a separate component of accumulated other comprehensive income.

#### P. EARNINGS PER SHARE

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the weighted average number of common shares outstanding during the period plus shares issuable upon the assumed exercise of dilutive common share options and vesting of performance-accelerated restricted shares using the treasury stock method.

The number of shares used in the calculation of earnings per share for each year presented is as follows:

(In thousands)	2012	2011	2010
Weighted Average Shares Outstanding — Basic	26,699	26,588	26,450
Dilutive Options and Performance-Accelerated Restricted Stock	331	315	288
Shares — Diluted	27,030	26,903	26,738

Options to purchase 126,787 shares at prices ranging from \$35.69-\$45.81 were outstanding during the year ended September 30, 2012, but were not included in the respective computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares. Options to purchase 372,653 shares at prices ranging from \$32.55-\$54.88 were outstanding during the year ended September 30, 2011, but were not included in the respective computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares. Options to purchase 569,363 shares at prices ranging from \$32.55-\$54.88 were outstanding during the year ended September 30, 2010, but were not included in the respective computation of diluted EPS because the options' exercise price was greater than the average market price of the common shares. These options expire in various periods through 2014.

Approximately 175,000, 173,000 and 214,000 restricted shares were outstanding but unearned at September 30, 2012, 2011 and 2010, respectively, and, therefore, were not included in the respective years' computations of diluted EPS.

#### Q. SHARE-BASED COMPENSATION

The Company provides compensation benefits to certain key employees under several share-based plans providing for employee stock options and/or performance-accelerated restricted shares (restricted shares), and to non-employee directors under a non-employee directors compensation plan. Share-based payment expense is measured at the grant date based on the fair value of the award and is recognized on a straight-line basis over the requisite service period (generally the vesting period of the award).

#### R. ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss of \$(25.4) million at September 30, 2012, consisted of \$(28.7) million related to the pension net actuarial loss; and \$3.3 million related to currency

translation adjustments. Accumulated other comprehensive loss of \$(19.2) million at September 30, 2011, consisted of \$(24.5) million related to the pension net actuarial loss; and \$5.3 million related to currency translation adjustments.

#### S. DEFERRED REVENUE AND COSTS

Deferred revenue and costs are recorded when products or services have been provided but the criteria for revenue recognition have not been met. If there is a customer acceptance provision or there is uncertainty about customer acceptance, revenue and costs are deferred until the customer has accepted the product or service.

#### T. DERIVATIVE FINANCIAL INSTRUMENTS

All derivative financial instruments are reported on the balance sheet at fair value. The accounting for changes in fair value of a derivative instrument depends on whether it has been designated and qualifies as a hedge and on the type of hedge. For each derivative instrument designated as a cash flow hedge, the effective portion of the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. For each derivative instrument designated as a fair value hedge, the gain or loss on the derivative and the offsetting gain or loss on the hedged item are recognized immediately in earnings. Regardless of type, a fully effective hedge will result in no net earnings impact while the derivative is outstanding. To the extent that any hedge is ineffective at offsetting cash flow or fair value changes in the underlying hedged item, there could be a net earnings impact.

#### U. NEW ACCOUNTING STANDARDS

In July 2012, the FASB issued Accounting Standards Update No. 2012-02, *Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (ASU 2012-02). This ASU updates the rules on testing indefinite-lived intangible assets other than goodwill for impairment and permits the option to perform a qualitative assessment of the fair value of indefinite-lived intangible assets. This update is effective for fiscal years, and interim periods within those years, beginning after September 15, 2012, and is not expected to have a material impact on the Company's financial statements.

## 2. Acquisitions

### 2012

During 2012, the Company acquired a minority interest in Calico Energy, Inc. (Calico) for \$3.3 million in cash. Calico, headquartered in Seattle, Washington, is a provider of demand response software used in smart grid deployments and will be offered in connection with Aclara's Smart Communications Network solution. This investment is accounted for under the cost method and is classified as a long-term Other asset on the Company's consolidated balance sheet at September 30, 2012.

### 2011

On February 28, 2011, the Company acquired the capital stock of EMV Elektronische Messgeräte Vertriebs - GmbH, together with its subsidiary EMSCREEN Electromagnetic Screening GmbH (collectively, EMV) for a purchase price of approximately \$5 million, inclusive of cash acquired. EMV, with operations in Taufkirchen, Germany, provides turnkey systems and shielded environments for research, development and quality assurance testing of electronic equipment. EMV's operating results, since the date of acquisition, are included within the Test segment and the Company recorded approximately \$4.8 million of goodwill as a result of the transaction.

### 2010

Effective July 31, 2010, the Company acquired the capital stock of Crissair, Inc. (Crissair) for a purchase price of approximately \$27 million, net of cash acquired. Crissair, headquartered in Palmdale, California, is a manufacturer of high-quality hydraulic, fuel and pneumatic system components for the aerospace industry. The operating results for Crissair, since the date of acquisition, are included within the Filtration segment. The Company recorded approximately \$9 million of goodwill as a result of the transaction, \$4.3 million of trade names and \$7.4 million of amortizable identifiable intangible assets consisting of customer relationships.

On September 3, 2010, the Company acquired the capital stock of Xtensible Solutions, Inc. (Xtensible) for a purchase price of approximately \$4 million in cash plus contingent consideration. Xtensible is a provider of information management and integration solutions to the utility industry worldwide and its operating results, since the date of acquisition, are included within the USG segment (as part of Aclara through 2012). The agreement includes contingent consideration based on target revenues to be earned and paid out over the three and a half year period from the date of acquisition. The Company recorded approximately \$15 million of goodwill as a result of

the transaction. The Company revalued the earnout obligation based on current forecasted revenues and recorded income of \$4.5 million and \$7.6 million in Other (income) expenses, net in 2012 and 2011, respectively.

All of the Company's acquisitions have been accounted for using the purchase method of accounting and accordingly, the respective purchase prices were allocated to the assets (including intangible assets) acquired and liabilities assumed based on estimated fair values at the date of acquisition. The financial results from these acquisitions have been included in the Company's financial statements from the date of acquisition. Pro forma financial information related to the Company's acquisitions was not presented as it was not significant to the Company's results of operations. None of the goodwill recorded as part of the acquisitions mentioned above is expected to be deductible for U.S. Federal or state income tax purposes except for the goodwill recorded in connection with the Xtensible acquisition.

### 3. Goodwill and Other Intangible Assets

Included on the Company's Consolidated Balance Sheets at September 30, 2012, and 2011 are the following intangible assets gross carrying amounts and accumulated amortization:

(Dollars in millions)	2012	2011
Goodwill	\$ 361.3	361.9
Intangible assets with determinable lives:		
Patents		
Gross carrying amount	\$ 13.5	13.5
Less: accumulated amortization	13.3	13.3
Net	\$ 0.2	0.2
Capitalized software		
Gross carrying amount	\$ 129.8	116.7
Less: accumulated amortization	67.0	57.4
Net	\$ 62.8	59.3
Customer Relationships		
Gross carrying amount	\$ 61.4	61.4
Less: accumulated amortization	14.7	11.6
Net	\$ 46.7	49.8
Other		
Gross carrying amount	\$ 10.3	10.3
Less: accumulated amortization	10.3	9.6
Net	\$ —	0.7
Intangible assets with indefinite lives:		
Trade names	\$ 121.7	121.8

The Company performed its annual evaluation of goodwill and intangible assets for impairment during the fourth quarter of fiscal 2012 and concluded no impairment existed at September 30, 2012.

The changes in the carrying amount of goodwill attributable to each business segment for the years ended September 30, 2012, and 2011 are as follows:

(Dollars in millions)	USG	Test	Filtration	Total
Balance as of				
September 30, 2010	\$ 296.1	30.5	29.1	355.7
Acquisitions/adjustments	1.7	4.3	0.2	6.2
Balance as of				
September 30, 2011	297.8	34.8	29.3	361.9
Acquisitions/adjustments	(0.5)	(0.1)	—	(0.6)
Balance as of				
September 30, 2012	\$297.3	34.7	29.3	361.3

Amortization expense related to intangible assets with determinable lives was \$13.3 million, \$12 million and \$11.6 million in 2012, 2011 and 2010, respectively. The Company recorded \$4.7 million, \$4.7 million and \$4.5 million of amortization expense related to Aclara PLS's TWACS NG software in 2012, 2011 and 2010, respectively. Patents are amortized over the life of the patents, generally 17 years. Capitalized software is amortized over the estimated useful life of the software, generally three to seven years. Customer relationships are generally amortized over twenty years. Intangible asset amortization for fiscal years 2013 through 2017 is estimated at approximately \$12 million per year.

### 4. Accounts Receivable

Accounts receivable, net of the allowance for doubtful accounts, consist of the following at September 30, 2012, and 2011:

(Dollars in thousands)	2012	2011
Commercial	\$147,685	137,498
U.S. Government and prime contractors	3,366	6,585
Total	\$151,051	144,083

## 5. Inventories

Inventories consist of the following at September 30, 2012, and 2011:

(Dollars in thousands)	2012	2011
Finished goods	\$30,250	30,192
Work in process — including long-term contracts	30,372	23,139
Raw materials	47,439	43,655
Total	\$108,061	96,986

## 6. Property, Plant and Equipment

Depreciation expense of property, plant and equipment for the years ended September 30, 2012, 2011 and 2010 was \$11.4 million, \$11.5 million and \$10.5 million, respectively.

The Company leases certain real property, equipment and machinery under noncancelable operating leases. Rental expense under these operating leases for the years ended September 30, 2012, 2011 and 2010 was \$8.3 million, \$8.1 million and \$7.7 million, respectively. Future aggregate minimum lease payments under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of September 30, 2012, are:

(Dollars in thousands)	
Years ending September 30:	
2013	\$ 7,585
2014	6,096
2015	4,811
2016	3,291
2017 and thereafter	2,251
Total	\$24,034

## 7. Income Tax Expense

Total income tax expense (benefit) for the years ended September 30, 2012, 2011 and 2010 was allocated to income tax expense from continuing operations.

The components of income before income taxes consisted of the following for the years ended September 30:

(Dollars in thousands)	2012	2011	2010
United States	\$67,297	73,275	66,639
Foreign	4,387	3,683	3,026
Total income before income taxes	\$71,684	76,958	69,665

The principal components of income tax expense (benefit) for the years ended September 30, 2012, 2011 and 2010 consist of:

(Dollars in thousands)	2012	2011	2010
Federal			
Current	\$16,868	15,708	17,585
Deferred	4,084	5,578	4,199
State and local:			
Current	1,659	2,218	2,193
Deferred	531	580	230
Foreign:			
Current	1,897	3,104	1,130
Deferred	(234)	(2,731)	(518)
Total	\$24,805	24,457	24,819

The actual income tax expense (benefit) for the years ended September 30, 2012, 2011 and 2010 differs from the expected tax expense for those years (computed by applying the U.S. Federal corporate statutory rate) as follows:

	2012	2011	2010
Federal corporate statutory rate	35.0%	35.0%	35.0%
State and local, net of Federal benefits	3.3	3.6	3.1
Foreign	0.1	(2.2)	(1.5)
Research credit	(0.4)	(2.0)	0.3
Domestic production deduction	(2.4)	(2.5)	(1.9)
Change in uncertain tax positions	(2.6)	(0.5)	0.1
Purchase accounting adjustment	0.7	—	—
Other, net	0.9	0.4	0.5
Effective income tax rate	34.6%	31.8%	35.6%

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities at September 30, 2012, and 2011 are presented below.

(Dollars in thousands)	2012	2011
Deferred tax assets:		
Inventories, long-term contract accounting, contract cost reserves and other	\$ 7,819	6,029
Pension and other postretirement benefits	13,437	11,341
Net operating loss carryforward — domestic	562	687
Net operating loss carryforward — foreign	3,841	3,419
Capital loss carryforward	240	240
Other compensation-related costs and other cost accruals	17,589	17,316
State credit carryforward	997	1,240
Total deferred tax assets	44,485	40,272
Deferred tax liabilities:		
Plant and equipment, depreciation methods, acquisition asset allocations, and other	(109,905)	(104,082)
Net deferred tax liabilities before valuation allowance	(65,420)	(63,810)
Less valuation allowance	(942)	(873)
Net deferred tax liabilities	\$ (66,362)	(64,683)

The Company has a foreign net operating loss carryforward of \$12.5 million at September 30, 2012, which reflects tax loss carryforwards in Brazil, Germany and the United Kingdom. These losses have no expiration date. The Company also has net state research and other credit carryforwards of \$1 million of which \$0.6 million expires between 2022 and 2027. The remaining \$0.4 million does not have an expiration date.

At September 30, 2012, the Company has established a valuation allowance of \$0.2 million against the capital loss carryforward generated in 2008, as such loss carryforward may not be realized in future periods. In addition, the Company has established a valuation allowance against certain net operating loss (NOL) carryforwards in foreign jurisdictions which may not be realized in future periods. The valuation allowance established against the foreign NOL carryforwards was \$0.7 million at September 30, 2012, and 2011, respectively. The Company classifies its valuation allowance related to deferred taxes on a pro rata basis.

The Company's foreign subsidiaries have accumulated unremitted earnings of \$34 million and cash of \$20.9 million at September 30, 2012. No deferred taxes have been provided

on the accumulated unremitted earnings because these funds are not needed to meet the liquidity requirements of the Company's U.S. operations and it is the Company's intention to reinvest these earnings indefinitely. In the event these foreign entities' earnings were distributed, it is estimated that U.S. taxes, net of available foreign tax credits, of approximately \$5.6 million would be due, which would correspondingly reduce the Company's net earnings. No significant portion of the Company's foreign subsidiaries' earnings was taxed at a very low tax rate.

As of September 30, 2012, the Company had \$1.8 million of unrecognized benefits (see table below), which, net of Federal benefit, if recognized, would affect the Company's effective tax rate.

A reconciliation of the Company's unrecognized tax benefits for the years ended September 30, 2012, and 2011 is presented in the table below:

(Dollars in millions)	2012	2011
Balance as of October 1,	\$ 3.6	3.2
Increases related to prior year tax positions	—	0.7
Decreases related to prior year tax positions	(0.3)	—
Increases related to current year tax positions	0.1	0.2
Lapse of statute of limitations	(1.6)	(0.5)
Balance as of September 30,	\$ 1.8	3.6

The Company anticipates a \$0.2 million reduction in the amount of unrecognized tax benefits in the next 12 months as a result of a lapse of the applicable statute of limitations. The Company's policy is to include interest related to unrecognized tax benefits in income tax expense and penalties in operating expense. As of September 30, 2012, 2011 and 2010, the Company had accrued interest related to uncertain tax positions of \$0.1 million, \$0.2 million and \$0.1 million, respectively, net of Federal income tax benefit, on its Consolidated Balance Sheet. No significant penalties have been accrued.

The principal jurisdictions for which the Company files income tax returns are U.S. Federal and the various city, state, and international locations where the Company has operations. The U.S. Federal tax years for the periods ended September 30, 2009, and forward remain subject to income tax examination. Various state tax years for the periods ended September 30, 2008, and forward remain subject to income tax examinations.

The Company is subject to income tax in many jurisdictions outside the United States, none of which is individually material to the Company's financial position, statements of cash flows, or results of operations.

## 8. Debt

Debt consists of the following at September 30, 2012, and 2011:

(Dollars in thousands)	2012	2011
Revolving credit facility, including current portion	\$115,000	125,000
Current portion of long-term debt	(50,000)	(50,000)
Total long-term debt, less current portion	\$ 65,000	75,000

On May 14, 2012, the Company entered into a new \$450 million five-year revolving credit facility with JPMorgan Chase Bank, N.A., as administrative agent, PNC Bank, N.A., as syndication agent, and eight other participating lenders (the "Credit Facility"). The Credit Facility replaced the Company's \$330 million revolving credit facility that would otherwise have matured in November, 2012. Through a credit facility expansion option, the Company may elect to increase the size of the Credit Facility by entering into incremental term loans, in any agreed currency, at a minimum of \$25 million each up to a maximum of \$250 million aggregate.

At September 30, 2012, the Company had approximately \$320 million available to borrow under the Credit Facility, plus a \$250 million increase option, in addition to \$30.2 million cash on hand. The Company classified \$50 million as the current portion of long-term debt as of September 30, 2012, as the Company intends to repay this amount within the next twelve months; however, the Company has no contractual obligation to repay such amount during the next twelve months. The Company's ability to access the additional \$250 million increase option of the Credit Facility is subject to acceptance by participating or other outside banks.

The credit facility requires, as determined by certain financial ratios, a facility fee ranging from 17.5 to 35.0 basis points per annum on the unused portion. The terms of the facility provide that interest on borrowings may be calculated at a spread over the London Interbank Offered Rate (LIBOR) or based on the prime rate, at the Company's election. The facility is secured by the unlimited guaranty of the Company's

material domestic subsidiaries and a 65% pledge of the material foreign subsidiaries' share equity. The financial covenants of the Credit Facility include a leverage ratio and an interest coverage ratio. During 2012 and 2011, the maximum aggregate short-term borrowings at any month-end were \$141 million and \$159 million, respectively; the average aggregate short-term borrowings outstanding based on month-end balances were \$126 million and \$143 million, respectively; and the weighted average interest rates were 1.20%, 1.40%, and 1.87% for 2012, 2011 and 2010, respectively. The letters of credit issued and outstanding under the Credit Facility totaled \$15.3 million and \$15 million at September 30, 2012, and 2011, respectively.

## 9. Capital Stock

The 30,044,486 and 29,956,904 common shares as presented in the accompanying Consolidated Balance Sheets at September 30, 2012, and 2011 represent the actual number of shares issued at the respective dates. The Company held 3,453,249 and 3,320,926 common shares in treasury at September 30, 2012, and 2011, respectively.

In August 2012, the Company's Board of Directors authorized an expanded stock repurchase program whereby Management may repurchase shares of its outstanding common stock in the open market and otherwise throughout the period ending September 30, 2013. The total value authorized is the lesser of \$100 million, or the dollar limitation imposed by Section 6.07 of the Company's Credit Agreement dated May 14, 2012. The previous authorization was set to expire September 30, 2012. The Company repurchased approximately 150,000 shares during 2012 and there were no stock repurchases in 2011 or 2010.

## 10. Share-Based Compensation

The Company provides compensation benefits to certain key employees under several share-based plans providing for employee stock options and/or performance-accelerated restricted shares (restricted shares), and to non-employee directors under a non-employee directors compensation plan.

### Stock Option Plans

The Company's stock option awards are generally subject to graded vesting over a three-year service period. All outstanding options were granted at prices equal to fair market value at the date of grant. The options granted prior to September 30, 2003, have a 10-year contractual life from date of issuance, expiring in various periods through 2013.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Beginning in fiscal 2004, the options granted have a five-year contractual life from date of issuance. The Company recognizes compensation cost on a straight-line basis over the requisite service period for the entire award.

The fair value of each option award is estimated as of the date of grant using the Black-Scholes option pricing model. The weighted average assumptions for the periods indicated are noted below. Expected volatility is based on historical volatility of ESCO's stock calculated over the expected term of the option. The Company utilizes historical company data to

develop its expected term assumption. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the date of grant. There were no stock option grants during 2012 or 2011. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in 2010: expected dividend yield of 0.9%; expected volatility of 48.1%; risk-free interest rate of 1.9%; and expected term of 3.9 years.

Information regarding stock options awarded under the option plans is as follows:

	FY2012		FY2011		FY2010	
	Shares	Estimated Weighted Avg. Price	Shares	Estimated Weighted Avg. Price	Shares	Estimated Weighted Avg. Price
October 1,	435,054	\$35.58	761,931	\$35.15	891,826	\$33.63
Granted	—	—	—	—	2,000	\$32.55
Exercised	(100,872)	\$14.98	(104,912)	\$13.18	(73,765)	\$12.03
Cancelled	(208,366)	\$45.18	(221,965)	\$44.67	(58,130)	\$41.17
September 30,	125,816	\$36.29	435,054	\$35.58	761,931	\$35.15
At September 30,						
Reserved for future grant	1,301,090		1,115,776		949,062	
Exercisable	125,149	\$36.31	397,073	\$35.42	677,538	\$34.88

The aggregate intrinsic value of options exercised during 2012, 2011 and 2010 was \$2 million, \$2.4 million and \$1.3 million, respectively. The aggregate intrinsic value of stock options outstanding and exercisable at September 30, 2012, was \$0.3 million. The weighted-average contractual life of stock options outstanding at September 30, 2012, was 0.9 years. The weighted-average fair value of stock options per share granted in 2012, 2011 and 2010 was zero, zero, and \$11.90, respectively.

Summary information regarding stock options outstanding at September 30, 2012, is presented below:

Range of Exercise Prices	Options Outstanding		
	Number Outstanding at Sept. 30, 2012	Weighted-Average Remaining Contractual Life	Weighted Average Exercise Price
\$17.29 - \$32.55	8,000	0.8 years	\$21.11
\$35.69 - \$36.70	15,000	0.2 years	\$35.82
\$37.54 - \$37.98	102,816	1.0 years	\$37.54
	125,816	0.9 years	\$36.29

### Exercisable Options Outstanding

Range of Exercise Prices	Number Exercisable at Sept. 30, 2012	Weighted Average Exercise Price
\$17.29 - \$32.55	7,333	\$20.06
\$35.69 - \$36.70	15,000	\$35.82
\$37.54 - \$37.98	102,816	\$37.54
	125,149	\$36.31

### Performance-accelerated Restricted Share Awards

The performance-accelerated restricted shares (restricted shares) have a five-year term with accelerated vesting if certain targets based on market conditions are achieved. In these cases, if it is probable that the performance condition will be met, the Company recognizes compensation cost on a straight-line basis over the shorter performance period; otherwise, it will recognize compensation cost over the longer service period. Compensation cost for the majority of the outstanding restricted share awards is being recognized over the longer performance period as it is not probable the performance

condition will be met. The restricted share award grants were valued at the stock price on the date of grant. Pretax compensation expense related to the restricted share awards was \$4 million, \$3.6 million and \$3.6 million for the fiscal years ended September 30, 2012, 2011 and 2010, respectively.

The following summary presents information regarding outstanding restricted share awards as of September 30, 2012, and changes during the period then ended:

	Shares	Weighted Avg. Price
Nonvested at October 1, 2011	486,908	\$33.41
Granted	—	\$ —
Vested	(81,835)	\$37.14
Cancelled	(625)	\$38.09
Nonvested at September 30, 2012	404,448	\$32.65

#### Non-Employee Directors Plan

The non-employee directors compensation plan provides to each non-employee director a retainer of 900 common shares per quarter. Compensation expense related to the non-employee director grants was \$0.6 million, \$0.6 million and \$0.5 million for the years ended September 30, 2012, 2011 and 2010, respectively.

#### Total Share-Based Compensation

The total share-based compensation cost that has been recognized in results of operations and included within SG&A was \$4.6 million, \$4.7 million and \$4.6 million for the years ended September 30, 2012, 2011 and 2010, respectively. The total income tax benefit recognized in results of operations for share-based compensation arrangements was \$1.6 million, \$1.8 million and \$1.8 million for the years ended September 30, 2012, 2011 and 2010, respectively. The Company has elected to use tax law ordering rules when calculating the income tax benefit associated with its share-based payment arrangements. In addition, the Company elected to use the simplified method of calculating the pool of excess tax benefits available to absorb tax deficiencies recognized. As of September 30, 2012, there was \$5.9 million of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 1.6 years.

#### 11. Retirement and Other Benefit Plans

Substantially all domestic employees are covered by a defined contribution pension plan maintained by the Company. Effective December 31, 2003, the Company's defined benefit plan was frozen and no additional benefits have been accrued after that date. As a result, the accumulated benefit obligation and projected benefit obligation are equal. These frozen retirement income benefits are provided to employees under defined benefit pay-related and flat-dollar plans, which are noncontributory. In conjunction with the acquisition of Doble, the Company assumed responsibility for its defined benefit plan and has frozen the plan effective December 31, 2008, and no additional benefits have been accrued after that date. Effective October 1, 2009, the Company's defined benefit plan and Doble's benefit plan were merged into one plan. The annual contributions to the defined benefit retirement plans equal or exceed the minimum funding requirements of the Employee Retirement Income Security Act or applicable local regulations. In addition to providing retirement income benefits, the Company provides unfunded postretirement health and life insurance benefits to certain retirees. To qualify, an employee must retire at age 55 or later and the employee's age plus service must equal or exceed 75. Retiree contributions are defined as a percentage of medical premiums. Consequently, retiree contributions increase with increases in the medical premiums. The life insurance plans are noncontributory and provide coverage of a flat dollar amount for qualifying retired employees. Effective December 31, 2004, no new retirees are eligible for life insurance benefits.

The Company uses a measurement date of September 30 for its pension and other postretirement benefit plans. The Company has an accrued benefit liability of \$0.8 million at September 30, 2012, and 2011, respectively, related to its other postretirement benefit obligations. All other information related to its postretirement benefit plans is not considered material to the Company's results of operations or financial condition.

The following tables provide a reconciliation of the changes in the pension plans and fair value of assets over the two-year

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

period ended September 30, 2012, and a statement of the funded status as of September 30, 2012, and 2011:

(Dollars in millions)	2012	2011
<b>Reconciliation of benefit obligation</b>		
Net benefit obligation at beginning of year	<b>\$83.2</b>	79.4
Service cost	<b>0.1</b>	0.1
Interest cost	<b>3.8</b>	3.9
Actuarial loss	<b>13.4</b>	4.8
Settlements	<b>—</b>	(1.8)
Gross benefits paid	<b>(3.4)</b>	(3.2)
Net benefit obligation at end of year	<b>\$97.1</b>	83.2

(Dollars in millions)	2012	2011
<b>Reconciliation of fair value of plan assets</b>		
Fair value of plan assets at beginning of year	<b>\$50.5</b>	49.2
Actual return on plan assets	<b>9.0</b>	0.8
Employer contributions	<b>5.0</b>	5.5
Gross benefits paid	<b>(3.4)</b>	(3.2)
Settlements	<b>—</b>	(1.8)
Fair value of plan assets at end of year	<b>\$61.1</b>	50.5

(Dollars in millions)	2012	2011
<b>Funded Status</b>		
Funded status at end of year	<b>\$(36.0)</b>	(32.7)
Unrecognized prior service cost	<b>—</b>	—
Unrecognized net actuarial (gain) loss	<b>—</b>	—
Accrued benefit cost	<b>(36.0)</b>	(32.7)
Amounts recognized in the Balance Sheet consist of:		
Noncurrent asset	<b>—</b>	—
Current liability	<b>(0.5)</b>	(0.2)
Noncurrent liability	<b>(35.5)</b>	(32.5)
Accumulated other comprehensive (income)/loss (before tax effect)	<b>48.3</b>	41.3
Amounts recognized in Accumulated Other Comprehensive (Income)/Loss consist of:		
Net actuarial loss	<b>48.2</b>	41.2
Prior service cost	<b>0.1</b>	0.1
Accumulated Other Comprehensive (Income)/Loss	<b>\$ 48.3</b>	41.3

The following table provides the components of net periodic benefit cost for the plans for the years ended September 30, 2012, 2011 and 2010:

(Dollars in millions)	2012	2011	2010
Service cost	<b>\$ 0.1</b>	0.1	0.2
Interest cost	<b>3.8</b>	3.9	4.0
Expected return on plan assets	<b>(4.1)</b>	(4.2)	(4.1)
Net actuarial loss	<b>1.5</b>	1.1	0.9
Settlement gain	<b>—</b>	—	(0.5)
Net periodic benefit cost	<b>1.3</b>	0.9	0.5
Defined contribution plans	<b>4.5</b>	3.7	4.3
Total	<b>\$ 5.8</b>	4.6	4.8

The discount rate used in measuring the Company's pension obligations was developed by matching yields of actual high-quality corporate bonds to expected future pension plan cash flows (benefit payments). Over 400 Aa-rated, non-callable bonds with a wide range of maturities were used in the analysis. After using the bond yields to determine the present value of the plan cash flows, a single representative rate that resulted in the same present value was developed. The expected long-term rate of return on plan assets assumption was determined by reviewing the actual investment return of the plans since inception and evaluating those returns in relation to expectations of various investment organizations to determine whether long-term future returns are expected to differ significantly from the past.

The following weighted-average assumptions were used to determine the net periodic benefit cost for the pension plans:

	2012	2011	2010
Discount rate	<b>4.50%</b>	5.00%	5.50%
Rate of increase in compensation levels	<b>N/A</b>	N/A	N/A
Expected long-term rate of return on assets	<b>7.5%</b>	8.00%	8.00%

The following weighted-average assumptions were used to determine the net periodic benefit obligations for the pension plans:

	2012	2011
Discount rate	3.75%	4.5%
Rate of increase in compensation levels	N/A	N/A

The assumed rate of increase in compensation levels is not applicable in 2012, 2011 and 2010 as the plan was frozen in earlier years.

The asset allocation for the Company's pension plans at the end of 2012 and 2011, the Company's acceptable range and the target allocation for 2013, by asset category, follows:

Asset Category	Target Allocation	Acceptable Range	Percentage of Plan Assets at Year-end	
	2013		2012	2011
Equity securities	60%	50-70%	59%	56%
Fixed income	40%	30-50%	39%	43%
Cash/cash equivalents	0%	0-5%	2%	1%

The Company's pension plan assets are managed by outside investment managers and assets are rebalanced when the target ranges are exceeded. Pension plan assets consist principally of marketable securities including common stocks, bonds, and interest-bearing deposits. The Company's investment strategy with respect to pension assets is to achieve a total rate of return (income and capital appreciation) that is sufficient to accomplish the purpose of providing retirement benefits to all eligible and future retirees of the pension plan. The Company regularly monitors performance and compliance with investment guidelines.

#### FAIR VALUE OF FINANCIAL MEASUREMENTS

The fair values of the Company's defined benefit plan investments as of September 30, 2012, by asset category, are as follows:

(Dollars in millions)	Level 1	Level 2	Level 3	Total
Investments at Fair Value:				
Cash and Cash Equivalents	\$0.8	—	—	0.8
Common and Preferred Stock Funds:				
Domestic large capitalization	9.3	0.5	—	9.8
Domestic small/mid capitalization	9.3	0.5	—	9.8
International funds	9.3	0.5	—	9.8
Fixed Income Funds	3.1	24.8	—	27.9
Real Estate Investments	2.9	0.1	—	3.0
Total Investments at Fair Value	\$34.7	26.4	—	61.1

For assets that are measured using quoted prices in active markets, the total fair value is the published market price per unit multiplied by the number of units held without consideration of transaction costs, which have been determined to be immaterial. Assets that are measured using significant other observable inputs are primarily valued by reference to quoted prices of markets that are not active. The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

**Cash and cash equivalents:** The carrying value of cash represents fair value as it consists of actual currency, and is classified as Level 1.

**Common and preferred stock funds:** The plans' common and preferred stock funds primarily consist of investments in listed U.S. and international companies' stocks. The stock investments are valued using quoted prices from the various public markets. Most equity securities trade on formal exchanges, both domestic and foreign (e.g. NYSE, NASDAQ, LSE), and can be accurately described as active markets. The observable valuation inputs are unadjusted quoted prices that represent active market trades and are classified as Level 1 or Level 2.

**Fixed income funds:** Fixed income funds consist of investments in U.S. and foreign corporate credit, U.S. and foreign government issues (including agencies and mortgages),

U.S. Treasuries, U.S. state and municipal securities and asset-backed securities. These investments are generally priced by institutional bids, which reflect estimated values based on underlying model frameworks at various dealers and vendors, or are formally listed on exchanges, where dealers exchange bid and ask offers to arrive at most executed transaction prices. These investments are classified as Level 1 or Level 2.

**Real estate investments:** The plan invests in U.S. real estate through indirect ownership entities, which are structured as limited partnerships or private real estate investment trusts (REITs). These real estate investments are classified as Level 1 or Level 2.

FASB ASC 825, *Financial Instruments*, establishes a three-level hierarchy for disclosure of fair value measurements, based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date, as follows:

**Level 1:** Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

**Level 2:** Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

**Level 3:** Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

#### EXPECTED CASH FLOWS

Information about the expected cash flows for the pension and other postretirement benefit plans follows:

(Dollars in millions)	Pension Benefits	Other Benefits
Expected Employer Contributions — 2013	\$ 4.6	0.1
Expected Benefit Payments		
2013	4.2	0.1
2014	4.1	0.1
2015	4.2	—
2016	4.7	—
2017	4.6	0.1
2018-2022	\$ 26.2	0.3

#### 12. Other Financial Data

Items charged to operations during the years ended September 30, 2012, 2011 and 2010 included the following:

(Dollars in thousands)	2012	2011	2010
Salaries and wages (including fringes)	\$197,642	187,214	160,780
Maintenance and repairs	5,389	4,530	3,440
Research and development (R&D) costs:			
Company-sponsored	30,067	33,574	32,199
Customer-sponsored	9,171	8,527	4,035
Total R&D	\$ 39,238	42,101	36,234
Other engineering costs	17,646	11,490	13,250
Total R&D and other engineering costs	\$ 56,884	53,591	49,484
As a % of net sales	8.3%	7.7%	8.1%

A reconciliation of the changes in accrued product warranty liability for the years ended September 30, 2012, 2011 and 2010 is as follows:

(Dollars in thousands)	2012	2011	2010
Balance as of October 1,	\$ 3,834	3,877	4,370
Additions charged to expense	2,357	3,275	1,813
Deductions	(2,711)	(3,318)	(2,306)
Balance as of September 30,	\$ 3,480	3,834	3,877

#### 13. Business Segment Information

The Company is organized based on the products and services it offers. Under this organizational structure, the Company has three reporting segments: Utility Solutions Group (USG), RF Shielding and Test (Test) and Filtration/Fluid Flow (Filtration).

The USG segment's operations consist of: Aclara Technologies LLC (Aclara) and Doble Engineering Company (Doble).

Aclara is a proven supplier of special purpose fixed-network communications systems for electric, gas and water utilities, including hardware and software to support advanced metering applications. Aclara's STAR® Network system and TWACS®

technology provide advanced radio-frequency and power-line based fixed-network technologies proven to meet the wide-ranging data communications requirements of utilities worldwide. Aclara Software applications add value across the utility enterprise, addressing meter and energy data management, distribution planning and operations, customer service, revenue management and integration solutions. Doble provides high-end, intelligent diagnostic test solutions for the electric power delivery industry and is a leading supplier of power factor and partial discharge testing instruments used to assess the integrity of high-voltage power delivery equipment.

Test segment operations represent the EMC Group, consisting primarily of ETS-Lindgren L.P. and Lindgren R.F. Enclosures, Inc. The EMC Group is an industry leader in providing its customers with the ability to identify, measure and contain magnetic, electromagnetic and acoustic energy. The EMC Group also manufactures radio frequency shielding products and components used by manufacturers of medical equipment, communications systems, electronic products, and shielded rooms for high-security data processing and secure communication.

The Filtration segment's operations consist of: PTI Technologies Inc., VACCO Industries, Crissair, Inc. and Thermoform Engineered Quality LLC. The companies within this segment design and manufacture specialty filtration products including hydraulic filter elements used in commercial aerospace applications, unique filter mechanisms used in micro-propulsion devices for satellites and custom designed filters for manned aircraft and submarines.

Accounting policies of the segments are the same as those described in the summary of significant accounting policies in Note 1 to the Consolidated Financial Statements. The operating units within each reporting segment have been aggregated

because of similar economic characteristics and meet the other aggregation criteria of FASB ASC 280.

The Company evaluates the performance of its operating units based on EBIT, which is defined as: Earnings Before Interest and Taxes. Intersegment sales and transfers are not significant. Segment assets consist primarily of customer receivables, inventories, capitalized software and fixed assets directly associated with the production processes of the segment. Segment depreciation and amortization is based upon the direct assets listed above.

#### NET SALES

(Dollars in millions)

Year ended September 30,	2012	2011	2010
Utility Solutions	<b>\$317.7</b>	349.6	348.3
Test	<b>175.9</b>	176.5	138.4
Filtration	<b>194.8</b>	167.6	120.8
Consolidated totals	<b>\$688.4</b>	693.7	607.5

No customers exceeded 10% of sales in 2012, 2011 or 2010.

#### EBIT

(Dollars in millions)

Year ended September 30,	2012	2011	2010
Utility Solutions	<b>\$ 46.2</b>	54.3	67.4
Test	<b>14.0</b>	18.6	12.2
Filtration	<b>38.0</b>	30.8	19.5
Reconciliation to consolidated totals (Corporate)	<b>(24.2)</b>	(24.2)	(25.5)
Consolidated EBIT	<b>74.0</b>	79.5	73.6
Less: interest expense	<b>(2.3)</b>	(2.5)	(3.9)
Earnings before income tax	<b>\$ 71.7</b>	77.0	69.7

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### IDENTIFIABLE ASSETS

(Dollars in millions)

Year ended September 30,	2012	2011
Utility Solutions	\$ 234.8	203.6
Test	92.8	100.6
Filtration	98.4	88.6
Corporate	607.8	619.0
Consolidated totals	\$1,033.8	1,011.8

Corporate assets consist primarily of goodwill, deferred taxes, acquired intangible assets and cash balances.

### CAPITAL EXPENDITURES

(Dollars in millions)

Year ended September 30,	2012	2011	2010
Utility Solutions	\$ 7.6	8.9	5.3
Test	2.2	1.5	1.9
Filtration	4.4	3.3	6.2
Corporate	0.6	—	—
Consolidated totals	\$14.8	13.7	13.4

In addition to the above amounts, the Company incurred expenditures for capitalized software of \$13.1 million, \$14.2 million and \$8.8 million in 2012, 2011 and 2010, respectively.

### DEPRECIATION AND AMORTIZATION

(Dollars in millions)

Year ended September 30,	2012	2011	2010
Utility Solutions	\$13.7	13.1	12.2
Test	2.5	2.2	2.3
Filtration	3.9	3.3	2.7
Corporate	4.7	4.9	4.9
Consolidated totals	\$24.8	23.5	22.1

### GEOGRAPHIC INFORMATION

#### Net sales

(Dollars in millions)

Year ended September 30,	2012	2011	2010
United States	\$501.9	512.4	466.1
Asia	67.4	45.9	54.2
Europe	61.7	57.1	36.7
Canada	22.0	19.6	13.6
Mexico	6.4	38.0	9.5
Other	29.0	20.7	27.4
Consolidated totals	\$688.4	693.7	607.5

#### Long-lived assets

(Dollars in millions)

Year ended September 30,	2012	2011
United States	\$70.3	67.3
Europe	2.6	3.4
Other	3.0	2.4
Consolidated totals	\$75.9	73.1

Net sales are attributed to countries based on location of customer. Long-lived assets are attributed to countries based on location of the asset.

### 14. Commitments and Contingencies

At September 30, 2012, the Company had \$15.3 million in letters of credit outstanding as guarantees of contract performance. As a normal course of business in which the Company is engaged, various claims, charges and litigation are asserted or commenced against the Company. With respect to claims and litigation asserted or commenced against the Company, it is the opinion of Management that final judgments, if any, which might be rendered against the Company are adequately reserved, covered by insurance, or are not likely to have a material adverse effect on its financial condition or results of operation.

# 15. Quarterly Financial Information (Unaudited)

(Dollars in thousands, except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal Year
<b>2012</b>					
Net sales	\$ 152,925	173,863	169,449	192,166	688,403
Net earnings	5,207	10,202	13,791	17,679	46,879
Basic earnings per share:					
Net earnings	0.20	0.38	0.52	0.66	1.76
Diluted earnings per share:					
Net earnings	0.19	0.38	0.51	0.65	1.73
Dividends declared per common share	\$ 0.08	0.08	0.08	0.08	0.32
<b>2011</b>					
Net sales	\$ 159,936	166,748	176,326	190,701	693,711
Net earnings	10,813	13,227	13,078	15,383	52,501
Basic earnings per share:					
Net earnings	0.41	0.50	0.49	0.58	1.97
Diluted earnings per share:					
Net earnings	0.40	0.49	0.49	0.57	1.95
Dividends declared per common share	\$ 0.08	0.08	0.08	0.08	0.32

See Note 2 of Notes to Consolidated Financial Statements for discussion of acquisition activity.

During the fourth quarter of 2011, the Company recorded a \$6.5 million charge related to the write-down of certain Aclara inventory which was determined to be obsolete as next generation AMI products are currently being offered for sale and a \$6.6 million gain representing the revaluation of a contingent consideration liability related to a previous acquisition.

## MANAGEMENT'S STATEMENT OF FINANCIAL RESPONSIBILITY

The Company's Management is responsible for the fair presentation of the Company's financial statements in accordance with accounting principles generally accepted in the United States of America, and for their integrity and accuracy. Management is confident that its financial and business processes provide accurate information on a timely basis.

Management, with the oversight of ESCO's Board of Directors, has established and maintains a strong ethical climate in which the Company's affairs are conducted. Management also has established an effective system of internal controls that provide reasonable assurance as to the integrity and accuracy of the financial statements, and responsibility for the Company's assets. KPMG LLP, the Company's independent registered public accounting firm, reports directly to the Audit and Finance Committee of the Board of Directors. The Audit and Finance Committee has established policies consistent with corporate reform laws for auditor independence. In accordance with corporate governance listing requirements of the New York Stock Exchange:

- ▶ A majority of Board members are independent of the Company and its Management.
- ▶ All members of the key Board committees — the Audit and Finance, the Human Resources and Compensation and the Nominating and Corporate Governance Committees — are independent.
- ▶ The independent members of the Board meet regularly without the presence of Management.
- ▶ The Company has a clear code of ethics and a conflict of interest policy to ensure that key corporate decisions are made by individuals who do not have a financial interest in the outcome, separate from their interest as Company officials.

- ▶ The charters of the Board committees clearly establish their respective roles and responsibilities.
- ▶ The Company has a Corporate Ethics Committee, ethics officers at each operating location and an ombudsman hot line available to all domestic employees and all foreign employees have local ethics officers and access to the Company's ombudsman.

The Company has a strong financial team, from its executive leadership to each of its individual contributors. Management monitors compliance with its financial policies and practices over critical areas including internal controls, financial accounting and reporting, accountability, and safeguarding of its corporate assets. The internal audit control function maintains oversight over the key areas of the business and financial processes and controls, and reports directly to the Audit and Finance Committee. Additionally, all employees are required to adhere to the ESCO Code of Business Conduct and Ethics, which is monitored by the Corporate Ethics Committee.

Management is dedicated to ensuring that the standards of financial accounting and reporting that are established are maintained. The Company's culture demands integrity and a commitment to strong internal practices and policies.

The Consolidated Financial Statements have been audited by KPMG LLP, whose report is included herein.



Victor L. Richey  
Chairman, Chief Executive Officer,  
and President



Gary E. Muenster  
Executive Vice President,  
and Chief Financial Officer

The Company's Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States of America.

Because of its inherent limitations, any system of internal control over financial reporting, no matter how well designed, may not prevent or detect misstatements due to the possibility that a control can be circumvented or overridden or that misstatements due to error or fraud may occur that are not detected. Also, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed the effectiveness of the Company's internal control over financial reporting as of September 30, 2012, using criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and concluded that the Company maintained effective internal control over financial reporting as of September 30, 2012, based on these criteria.

Our internal control over financial reporting as of September 30, 2012, has been audited by KPMG LLP, an independent registered public accounting firm, as stated in its report which is included herein.



Victor L. Richey  
Chairman, Chief Executive Officer,  
and President



Gary E. Muenster  
Executive Vice President,  
and Chief Financial Officer

The Board of Directors and Shareholders  
ESCO Technologies Inc.:

We have audited the accompanying Consolidated Balance Sheets of ESCO Technologies Inc. and subsidiaries as of September 30, 2012, and 2011, and the related Consolidated Statements of Operations, Shareholders' Equity, and Cash Flows for each of the years in the three-year period ended September 30, 2012. We also have audited ESCO Technologies Inc.'s internal control over financial reporting as of September 30, 2012, based on criteria established in *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ESCO Technologies Inc.'s Management is responsible for these Consolidated Financial Statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on ESCO Technologies Inc.'s internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the Consolidated Financial Statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by Management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of Management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Consolidated Financial Statements referred to above present fairly, in all material respects, the financial position of ESCO Technologies Inc. and subsidiaries as of September 30, 2012, and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 2012, in conformity with U.S. generally accepted accounting principles. Also in our opinion, ESCO Technologies Inc. maintained, in all material respects, effective internal control over financial reporting as of September 30, 2012, based on criteria established in *Internal Control — Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**KPMG LLP**

St. Louis, Missouri  
November 29, 2012

## FIVE-YEAR FINANCIAL SUMMARY

(Dollars in millions, except per share amounts)	2012	2011	2010	2009	2008
For years ended September 30:					
Net sales	<b>\$688.4</b>	693.7	607.5	619.1	613.6
Net earnings from continuing operations	<b>46.9</b>	52.5	44.8	49.3	47.6
Net earnings (loss) from discontinued operations	—	—	—	0.1	(0.9)
Net earnings	<b>46.9</b>	52.5	44.8	49.4	46.7
Earnings (loss) per share:					
Basic:					
Continuing operations	<b>\$1.76</b>	1.97	1.70	1.88	1.84
Discontinued operations	—	—	—	—	(0.04)
Net earnings	<b>\$1.76</b>	1.97	1.70	1.88	1.80
Diluted:					
Continuing operations	<b>\$1.73</b>	1.95	1.68	1.86	1.81
Discontinued operations	—	—	—	—	(0.03)
Net earnings	<b>\$1.73</b>	1.95	1.68	1.86	1.78
As of September 30:					
Working capital from continuing operations	<b>139.2</b>	122.5	109.4	116.2	100.6
Total assets	<b>1,033.8</b>	1,011.8	974.3	923.7	928.1
Total debt	<b>115.0</b>	125.0	154.0	180.5	233.7
Shareholders' equity	<b>631.3</b>	600.7	556.0	517.3	468.2
Cash dividends declared per common share	<b>\$0.32</b>	0.32	0.32	—	—

See Note 2 of Notes to Consolidated Financial Statements for discussion of acquisition activity.

## COMMON STOCK MARKET PRICE

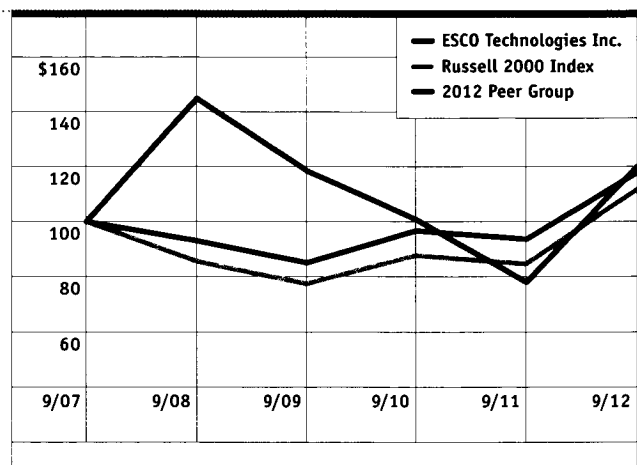
ESCO's common stock is listed on the New York Stock Exchange under the symbol "ESE." The following table summarizes the high and low prices of the common stock for each quarter of fiscal 2012 and 2011.

Quarter	2012		2011	
	High	Low	High	Low
First	<b>\$31.97</b>	<b>23.75</b>	\$38.83	31.54
Second	<b>38.37</b>	<b>28.48</b>	40.53	35.00
Third	<b>36.90</b>	<b>32.98</b>	38.14	33.40
Fourth	<b>39.50</b>	<b>33.05</b>	38.04	25.50

## MARKET PERFORMANCE

### Performance Graph

The adjacent graph presents a comparison of the cumulative total shareholder return on the Company's common stock as measured against the Russell 2000 Index and a peer group (the "2012 Peer Group"). The Company is not a component of the 2012 Peer Group, but it is a component of the Russell 2000 Index. The measurement period begins on September 30, 2007 and measures at each September 30 thereafter. These figures assume that all dividends, if any, paid over the measurement period were reinvested, and the starting value of each index and the investments in the Company's common stock were \$100 at the close of trading on September 30, 2007.



	9/07	9/08	9/09	9/10	9/11	9/12
<b>ESCO Technologies Inc.</b>	<b>100.00</b>	<b>144.92</b>	<b>118.53</b>	<b>100.85</b>	<b>78.01</b>	<b>120.06</b>
Russell 2000 Index	100.00	85.52	77.35	87.68	84.58	111.57
2012 Peer Group	100.00	93.02	85.07	96.73	93.64	117.84

The 2012 Peer Group is comprised of seven companies that correspond to the Company's three industry segments as follows: Utility Solutions Group segment (46% of the Company's 2012 total revenue) — Badger Meter Inc., Itron Inc., Echelon Corporation and Roper Industries Inc.; Test segment (26% of the Company's 2012 total revenue) — Aeroflex Holding Corporation; and Filtration/Fluid Flow segment (28% of the Company's 2012 total revenue) — Pall Corporation and Clarcor Inc.

In calculating the composite return of the 2012 Peer Group, the return of each company comprising the 2012 Peer Group is weighted by (a) its market capitalization in relation to the other companies in its corresponding Company industry segment, and (b) the percentage of the Company's 2012 total revenue represented by its corresponding Company industry segment.

### SHAREHOLDERS' ANNUAL MEETING

The Annual Meeting of Shareholders of ESCO Technologies Inc. will be held at 9:30 a.m. Pacific Time on Wednesday, February 6, 2013, at the headquarters of PTI Technologies Inc., a subsidiary of the Company, located at 501 Del Norte Blvd., Oxnard, CA 93030. You may access this Annual Report as well as the Notice of the meeting and the Proxy Statement on the Company's Annual Meeting website at <http://www.cfpproxy.com/5157>.

### CERTIFICATIONS

Pursuant to New York Stock Exchange (NYSE) requirements, the Company submitted to the NYSE the annual certifications, dated February 22, 2012 and February 24, 2011, by the Company's chief executive officer that he was not aware of any violations by the Company of NYSE's corporate governance listing standards. In addition, the Company filed with the Securities and Exchange Commission the certifications by the Company's chief executive officer and chief financial officer required under Section 302 of the Sarbanes-Oxley Act of 2002 as exhibits to the Company's Forms 10-K for its fiscal years ended September 30, 2012 and September 30, 2011.

### 10-K REPORT

**A copy of the Company's 2012 Annual Report on Form 10-K filed with the Securities and Exchange Commission is available to shareholders without charge. Direct your written request to Kate Lowrey, Director of Investor Relations, ESCO Technologies Inc., 9900A Clayton Road, St. Louis, Missouri 63124.**

**The Form 10-K is also available on the Company's website at [www.escotechnologies.com](http://www.escotechnologies.com).**

### INVESTOR RELATIONS

Additional investor-related information may be obtained by contacting the Director of Investor Relations at (314) 213-7277 or toll free at (888) 622-3726. Information is also available through the Company's website at [www.escotechnologies.com](http://www.escotechnologies.com) or via e-mail to [klowrey@escotechnologies.com](mailto:klowrey@escotechnologies.com).

### TRANSFER AGENT AND REGISTRAR

Shareholder inquiries concerning lost certificates, transfer of shares or address changes should be directed to:

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, NJ 07016-3572  
1 (800) 368-5948  
E-mail: [info@rtco.com](mailto:info@rtco.com)

### CAPITAL STOCK INFORMATION

ESCO Technologies Inc. common stock shares (symbol ESE) are listed on the New York Stock Exchange. There were approximately 2,358 holders of record of shares of common stock at November 9, 2012.

### INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

KPMG LLP  
10 South Broadway, Suite 900  
St. Louis, Missouri 63102

## MANAGEMENT AND BOARD OF DIRECTORS

### EXECUTIVE OFFICERS

**Victor L. Richey**  
Chairman, Chief Executive  
Officer, & President



**Gary E. Muenster**  
Executive Vice President &  
Chief Financial Officer



**Alyson S. Barclay**  
Senior Vice President,  
Secretary & General Counsel



### CORPORATE STAFF

**Deborah J. Boniske**  
Vice President  
Human Resources

**Mark S. Dunger**  
Vice President  
Planning & Development

**Richard A. Garretson**  
Vice President  
Tax

**Charles J. Kretschmer**  
Vice President

**Matthew J. Mainer**  
Vice President & Treasurer

**Michele A. Marren**  
Vice President & Corporate  
Controller

### OPERATING EXECUTIVES

**Brad Kitterman**  
President  
Aclara



**Sam R. Chapetta**  
Filtration Group Vice President &  
President, PTI Technologies Inc.



**David B. Zabetakis**  
President  
Doble Engineering Company



**Bruce E. Butler**  
President  
ETS-Lindgren LP



**Antonio E. Gonzalez**  
President  
VACCO Industries

**Mike Alfred**  
President  
Crissair, Inc.

**Randall K. Loga**  
President  
Thermoform Engineered  
Quality LLC

**William M. Giaccone**  
Senior Vice President &  
General Manager, Americas  
ETS-Lindgren LP

**Mark Mawdsley**  
Senior Vice President &  
Managing Director, Asia  
ETS-Lindgren LP

**Bryan Sayler**  
Senior Vice President,  
Test Solutions  
ETS-Lindgren LP

### BOARD OF DIRECTORS

**James M. McConnell**<sup>2,4</sup>  
Retired President &  
Chief Executive Officer  
Instron Corp.

**Gary E. Muenster**  
Executive Vice President &  
Chief Financial Officer

**Victor L. Richey**<sup>1</sup>  
Chairman, Chief Executive  
Officer, & President

**Larry W. Solley**<sup>3,4</sup>  
Retired Executive Vice President  
Emerson Electric Co.

**James M. Stolze**<sup>2</sup>  
Retired Vice President &  
Chief Financial Officer  
Stereotaxis, Inc.

**Donald C. Trauscht**<sup>1,2,3,4</sup>  
(Lead Director)  
Chairman  
BW Capital Corp.

**James D. Woods**<sup>3</sup>  
Chairman Emeritus &  
Retired Chief Executive Officer  
Baker Hughes Inc.

### Committee Membership

- 1 Executive Committee
- 2 Audit and Finance Committee
- 3 Human Resources and  
Compensation Committee
- 4 Nominating and Corporate  
Governance Committee



**ESCO Technologies Inc.**

9900A Clayton Road

St. Louis, MO 63124

[www.escotechnologies.com](http://www.escotechnologies.com)